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SIA SECURITIES INDUSTRY ASSOCIATION [Nov. 13, 1990 (Vol. XVI, No. 7)]

TRENDS

An Analysis of Emerging Trends in the Securities Industry

Produced by the SIA Research Department

SECURITIES INDUSTRY RECESSION ENTERS FOURTH YEAR

HIGHLIGHTS

1. Profits for all NYSE member firms through June barely broke $200 million. A few years ago, a single bond issue had to be larger than that to be considered "decent."

2. The industry's first half profit margin fell below 1%. ROE fared as poorly, below 2%. This most recent profit paucity follows a three-year earnings drought where the industry has suffered ROEs ranging from 5% to 10% and profit margins of 2% to 5%. In comparison, the U.S. manufacturing sector had a 17% ROE in the first half.

3. Third quarter results of publicly-held brokerage houses indicate industry profits for Q3 will deteriorate further to possibly half Q2's level. Only Discounters will show an upturn for Q3, thanks, in large part, to heavy commissions in July and August.

4. Commissions are down 11% this year and recent trends in NYSE volume do not portend improvement by year's end. If the trend holds, 1990 will be the second lowest year for industry commissions since 1985 (1988's $8 billion was worse).

5. For the first time since the 1970s, total industry revenue will not set a new record high. First half results project a 7% decrease in revenue from 1989's $59.5 billion.

6. Compensation costs are running a modest 2% below last year's level, based on first half results annualized. For most of the industry, the progress in reducing compensation costs is actually much better than 2%.

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Introduction — Industry Enters Fourth Year of Recession

The Iraq-Kuwait situation has exacerbated the fear that the U.S. economy is teetering on the brink of recession. News accounts proliferate on how surging oil prices, inflation, unemployment, etc. are about to spike our economy into a widening ditch. While the overall economy may be approaching the precipice, the securities industry slipped over the edge in 1987. Three years ago last month, the securities industry (but not the stock market) embarked on its longest down cycle since the early Seventies. Thus, as the economy teeters as we enter the fourth year of our own little recession, the brokerage industry, anything but counter-cyclical, had better be as prepared as our desert commandos to dig in for the duration.

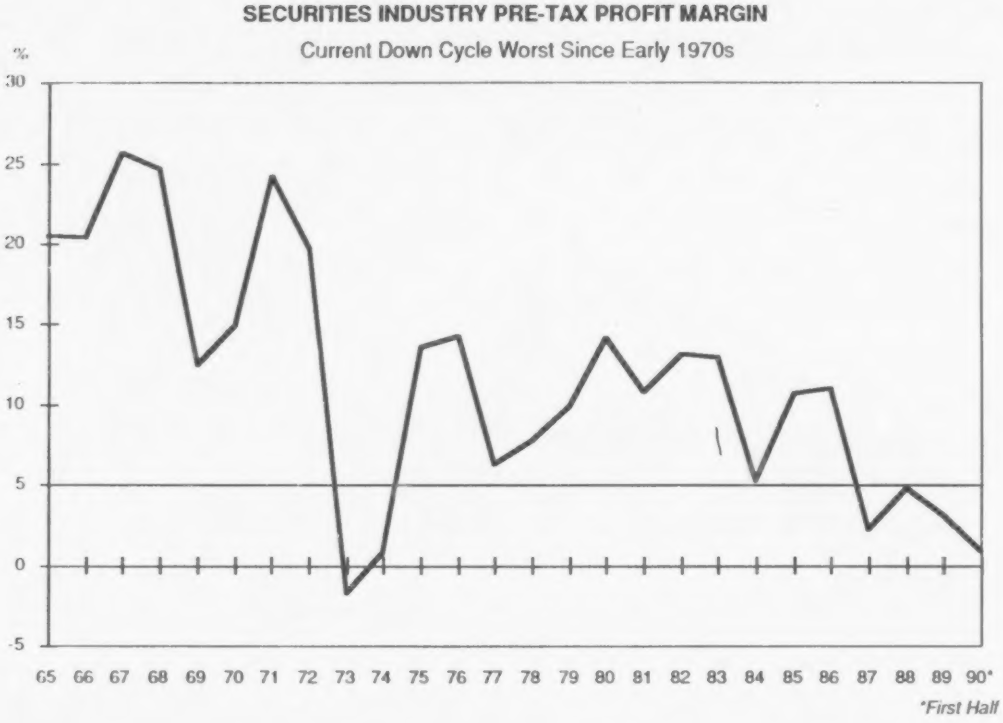
With that bearish beginning, the data on first half performance of the securities industry merely confirms the negative news. Pre-tax profits for all NYSE member broker-dealers through June barely broke $200 million. A few years ago a single bond issue had to be larger than that to be considered "decent."

Declining Profitability

The industry's first half pre-tax profit margin was below 1%. Pre-tax return-on-equity (ROE) fared as poorly, below 2%.. In comparison, the U.S. manufacturing sector had a 17% ROE in the first half. This most recent profit paucity follows a three-year earnings drought where the industry has suffered ROEs ranging from 5% to 10% and profit margins of 2% to 5% (Exhibit 1). It's painfully plain that the Nineties have begun on a very tough footing.

About the only good news this year is that the second quarter's $700 million pre-tax profit reversed the first quarter's loss of $500 million and last year's fourth quarter loss of $100 million. The reversal was mainly due to the absence of non-recurring losses, $191 million in 89:Q4 and $259 million in 90:Q1, write-offs incurred from downsizing at a few National Full Line firms. Also, the number of NYSE member firms posting red ink in the second quarter dropped to about 35% from 41% in Q1 and from 45% in last year's final quarter (Exhibit 2). But with from one-third to one-half of all members still posting losses each quarter since the crash, this is hardly encouraging.

Exhibit 1



SECURITIES INDUSTRY PRE-TAX PROFIT MARGIN

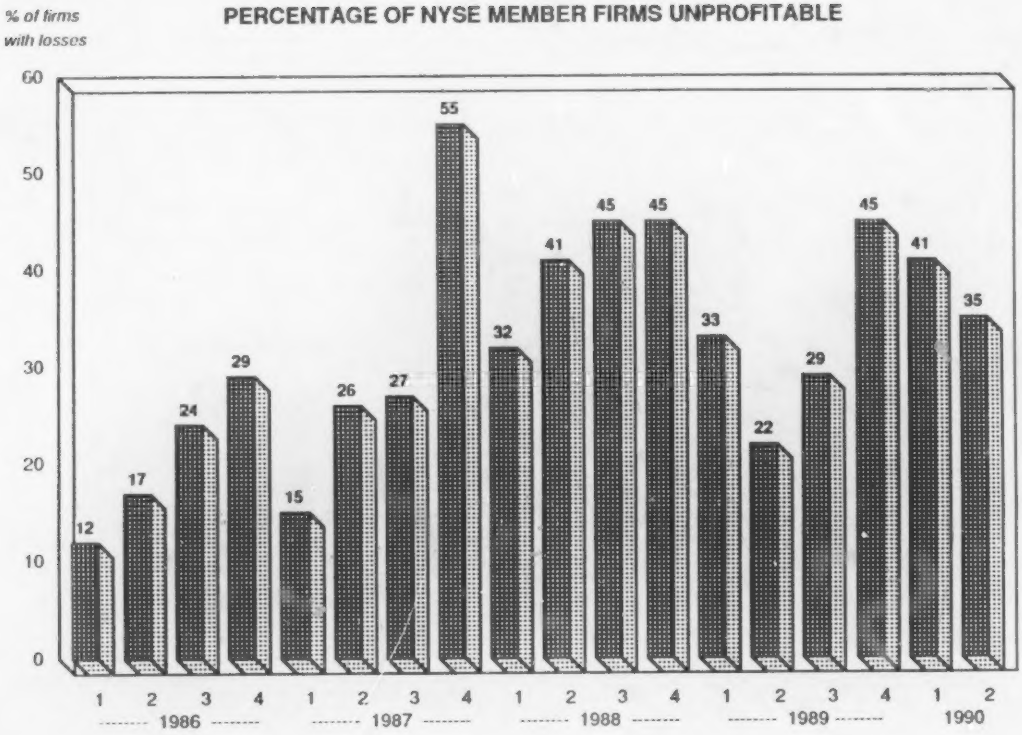
Current Down Cycle Worst Since Early 1970s

Third Quarter Results To Head Further South

Further, the Q3 results of the large, *publicly-held* brokerage houses indicate profits for this period will deteriorate further to possibly half Q2's level. Only publicly-held Discounters will show an upturn for Q3, thanks, in large part, to heavy commissions in the summer (though post-Labor Day results were weak).

Profits from principal transactions, an important revenue source for the largest firms (NFLs, LIBs, as well as large Regionals) were down markedly at the public firms in Q3. Investment banking revenues also softened in the summer. Commissions were flat, except at the Discounters, when September's trading vacuum reversed the benefits of July's and August's selling spree. September's close also saw some trading and investment losses posted, as firms marked their inventory to market. On the equity side alone, prices tumbled 18% from mid-July (market's peak) to the quarter's close, These positions, however, may eventually show profits when eventually closed on the books. Risk arbitrage losses were heavy also at several large firms.

Exhibit 2



Commission Revenues

There are always silver linings among dark clouds of data, but we'll take a "first the bad news" approach and save the good to last. By annualizing the first half results, some painful trends are obvious. Commissions are down 11% this year and current NYSE volume, averaging under 160 million shares daily this year (Exhibit 3) and dwindling since August's highs, doesn't portend improvement by year's end. If the trend holds, 1990 will be the second lowest year for industry commissions since 1985 (only 1988's $8 billion tally was worse). However, institutional commission rates, reportedly averaging around 5¢ per share, aren't likely to continue their long-term decline. Meanwhile, the press has reported that some firms have begun raising some retail rates.

As we've noted in previous issues of *Trends*, commissions continue to be less important to the industry's overall revenue picture. For the first half of this year, commissions accounted for only 16% of total revenues, starkly lower than in the pre-May Day fixed commission rate environment of the Sixties and early Seventies (Exhibit 4).

Exhibit 3

NYSE AVERAGE DAILY VOLUME

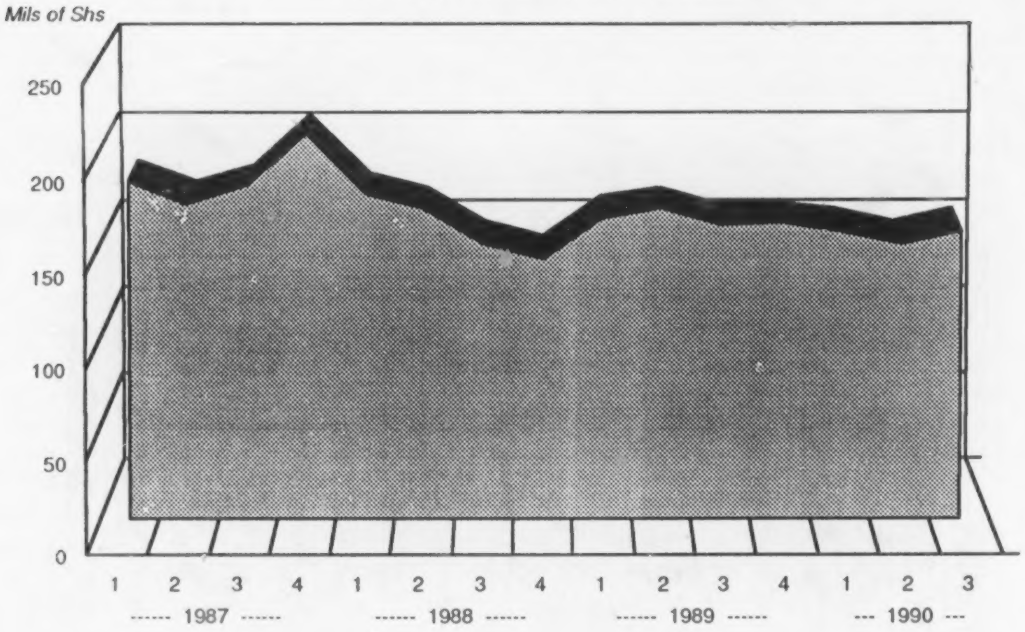
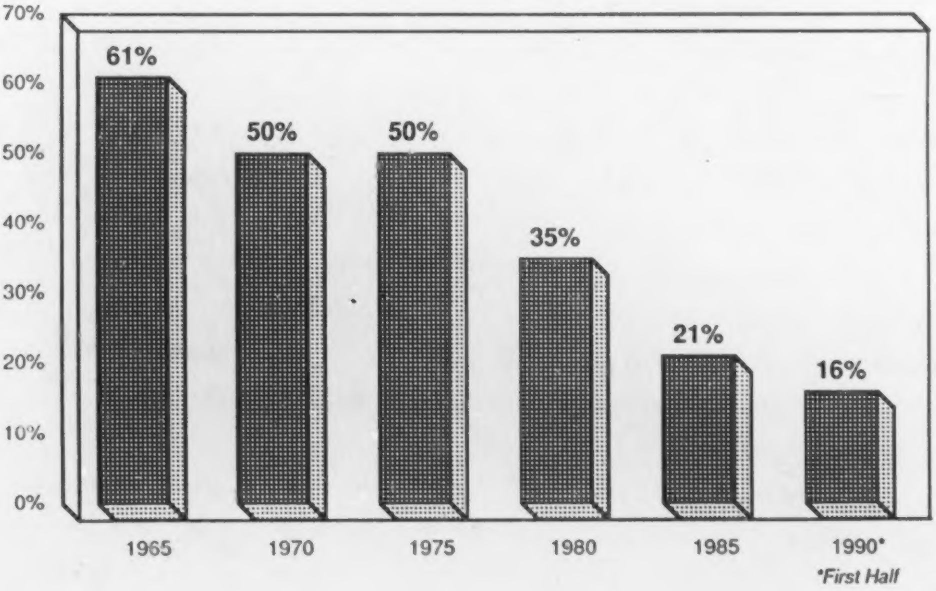


Exhibit 4

COMMISSIONS' SHARE OF INDUSTRY REVENUES



Revenues to Fall

For the first time since the Seventies, total industry revenue will not set a new record high. First half results project a decrease in revenues from last year's $59.5 billion to $55.3 billion, or down 7%. Although commissions, underwriting, margin interest and other revenue sources are all falling this year, the bulk of the decrease, nearly $3 billion, will come from "other securities related" revenue. Approximately 70% of this revenue line is interest related, a healthy portion from repo activity. Also, the Large Investment Banks post just over half of the industry's total revenue reported on this line.

Reduced Repos

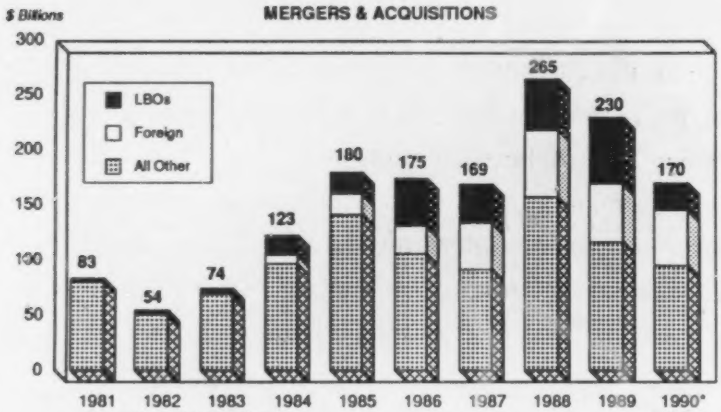
The industry's repo book decreased $23 billion, or 8%, over the 12 months ended June 30, 1990. It's reverse repo book dropped $43 billion or 16% over the same time frame. Both drops were mainly from the Large Investment Banks which dominate this business and the cutback breaks the trend of a long-term build up of these businesses in the Eighties. At year-end 1980, reverse repos accounted for $31 billion of assets in the industry; by 1989 they were $220 billion. Meanwhile, repos, as liabilities, grew from $32 billion to $278 billion. Now that firms have been forced to hold large bridge loans, some souring, following the collapse of the junk bond market, their short-term liquidity is down and they are moving to reduce short-term exposure.

Slashed M&A Activity

Another 20% of the "other securities related" revenue line comes from merger and acquisition-related fees which are off dramatically since the high-yield market tanked late last year. According to Michael Goldstein at Sanford C. Bernstein & Co., domestic M&A activity will fall by more than a third this year to $170 billion. That will be about half the heated level just two years ago (Exhibit 5). He also estimates that leveraged buy-out activity will be down 60% this year to just $25 billion; even foreign mergers in the U.S. will fall over 20% this year to just $42 billion.

Exhibit 5

MERGERS & ACQUISITIONS



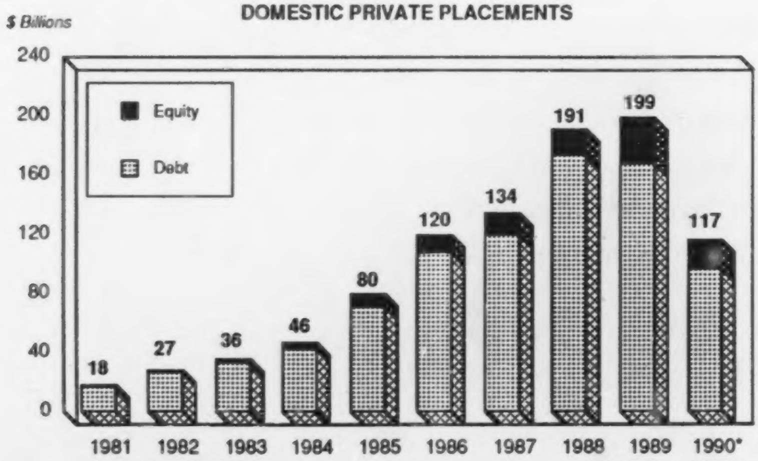
Source: Sanford C. Bernstein & Co. **Estimate*

Private Placements

The final 10% of the "securities related" line is attributable to private placement fees. After a decade of spectacular growth, not even stunted by the crash of 1987, the private placement market is expected to drop over 40% this year (based on first half results annualized, Exhibit 6). Three segments previously fueling the growth post-crash — acquisition-related financings, junk bonds and ESOP financings — nearly evaporated this year, all down between 50% to 70%. Acquisition-related private placements and junk bonds are inextricably intertwined since junk financed much of the M&A done in the Eighties but suffered the wrath of investor aversion since late last year. Also, the recently popular ESOP-related private placements were curtailed by IRS rule tightening.

Exhibit 6

DOMESTIC PRIVATE PLACEMENTS

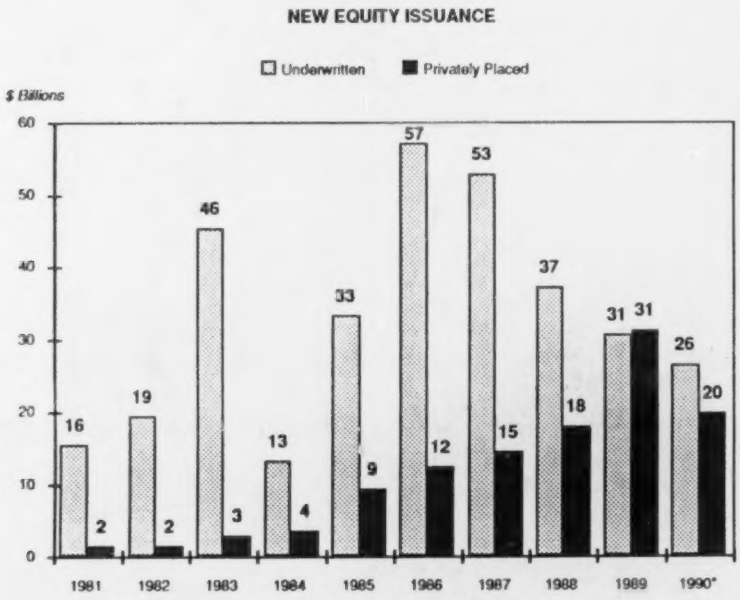


Source: Securities Data Co. **First Half Annualized*

Still, all areas of the private placement market witnessed declines this year. For debt issues, investors mainly sought investment grade issues just as these high credits reduced their private borrowings.

Privately placed equity reached a record $31 billion last year, thereby slightly exceeding underwritten equity for the first time ever. Underwritten equity, of course, had seen much higher levels during previous boom times but privates kept growing well after the crash as underwritings dwindled. This year, however, the downward trend in equity issuance caught up to the private market (Exhibit 7). Although the much heralded SEC Rule 144A was not available for issuers until the end of the first half, its use to date has been very limited and will have little impact on the private market this year.

Exhibit 7



Source: Securities Data Co. **Underwritten, 9 months annualized; private, 6 months annualized.*

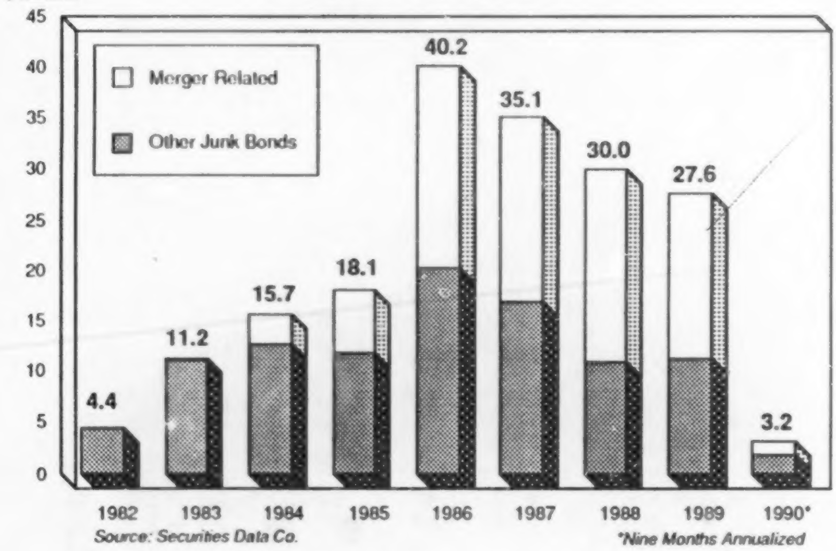
Large Investment Banks Post Investment Losses

Another revenue source tailing off for "the industry" is "investments for a firm's own account." Last year's closing quarter saw the "industry" post $221 million in investment account losses. This year's first quarter saw red ink again: $131 million. Although the second quarter showed an upturn to a minimal profit of $92 million, this line is still in the red for the year. Furthermore, this loss comes on the heels of a 65% decrease in investment gains from 1988 to 1989. The losses were almost entirely on the books of the Large Investment Banks, a group caught late last year with sizable inventories of junk bonds, equity stakes and bridge loans as the market for these products tanked.

Meanwhile, industry underwriting revenues, having fallen 20% last year, are down another 15% in 1990. Two of the highest margin products, equity and junk bonds, are very weak. Junk bond underwritings are practically nonexistent (Exhibit 8) and, as we saw earlier (Exhibit 7), *equity underwritings are at their lowest level in five years*. Again, the largest firms (NFLs and LIBs) dominate the industry's aggregates with over three-quarters of all underwriting revenue.

Exhibit 8

JUNK BONDS UNDERWRITTEN



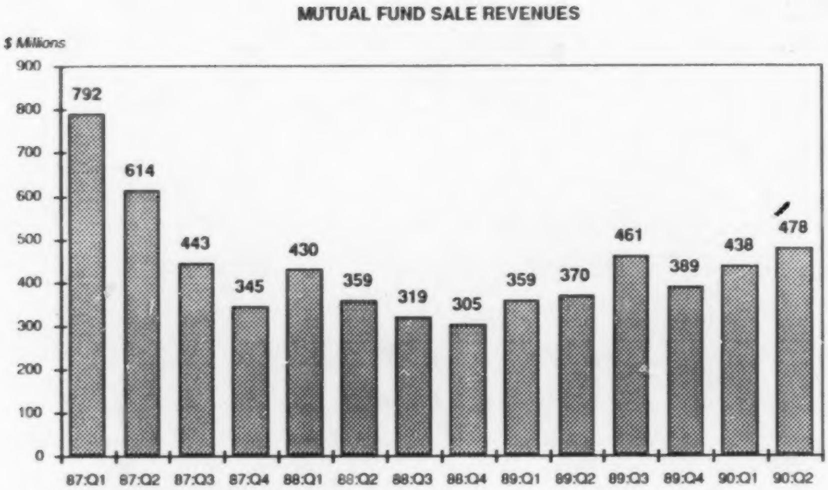
Source: Securities Data Co.

**Nine Months Annualized*

Mutual Funds

One area showing steady growth the past few years is the sale of mutual funds. *Investment Company Institute* figures show record sales of mutual funds, about evenly split between equity and income funds, so far this year. Although revenues are still only three-fifths the peak they reached during 1987's first quarter, they are still running at a post-crash high and trending up (Exhibit 9). Approximately 70% of these revenues are earned by the National Full Line firms with the majority of the balance earned by Regional firms.

Exhibit 9

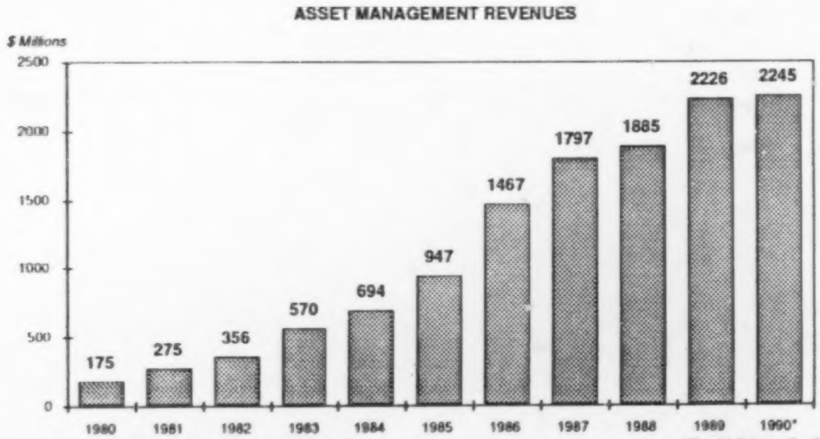


Source: SIA's Securities Industry DataBank

Asset management Fees

Another retail revenue source enjoying an upward trend is asset management. Many securities firms began pushing the concept of "asset gathering" during the late 1980s, i.e. encouraging the retail workforce (through various incentives) to bring customer assets "in-house." Hopefully, once in-house, more and more of a customers' assets will be concentrated within the firm thus netting more fee income through managing these assets (Exhibit 10) as well as creating additional revenue from more product lines which

Exhibit 10



Source: SIA's Securities Industry DataBank

**First Half Annualized*

otherwise would have been lost to other institutions, i.e. banks and mutual fund companies. This revenue source, more than half of which is booked by a handful of National Full Line firms, peaked in last year's final quarter ($713 million). This year's first two quarters, however, were still the next best periods ever ($529 and $594 million).

Margin Interest

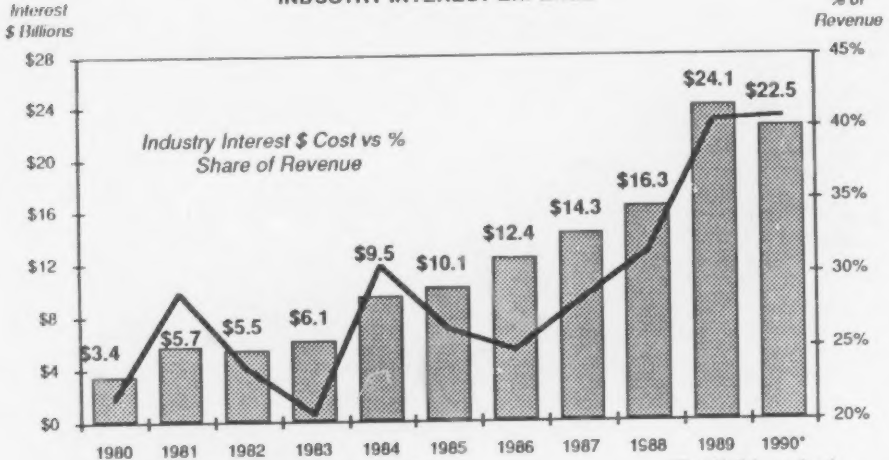
Industry revenues from margin interest has been pretty much flat the past four years at just over $3 billion annually, or 6% of total revenues. Nevertheless, it is running 15% below last year's record level, with the drop-off in this investment borrowing offsetting recent gains from brokerages' new home equity loan credit lending. The mix of firms earning margin interest has not changed much either. NFLs still dominate with about half the industry revenues from this source. LIBs still have 20%, Regionals maintained their 10% share, while Discounters have shown some growth and now have 7% of all revenues from this source.

Interest Expense

On the expense side of the P&L, gross interest expense is the industry's largest cost item, followed closely by compensation costs. Gross interest expense this year is running about 7% below last year's record level of $24 billion. But since total revenues also are down in 1990, interest's bite out of revenue is still about 40%, the same as last year. This is still a record high, however, and significantly higher than 1988's 32% bite or 1987's 28% cut from total revenues (Exhibit 11). Large firms increased their repo/ reverse-repo businesses at a faster clip than other business lines in recent years. The LIBs and NYCs still dominate this expense line, accounting for about 50% and 30%, respectively, of the total industry bill. NFLs, meanwhile, are down to only 18% of the industry's interest expense bill but, as mentioned, we've recently lost three major NFLs and their inventory book.

Exhibit 11

INDUSTRY INTEREST EXPENSE



Source: SIA's Securities Industry DataBank

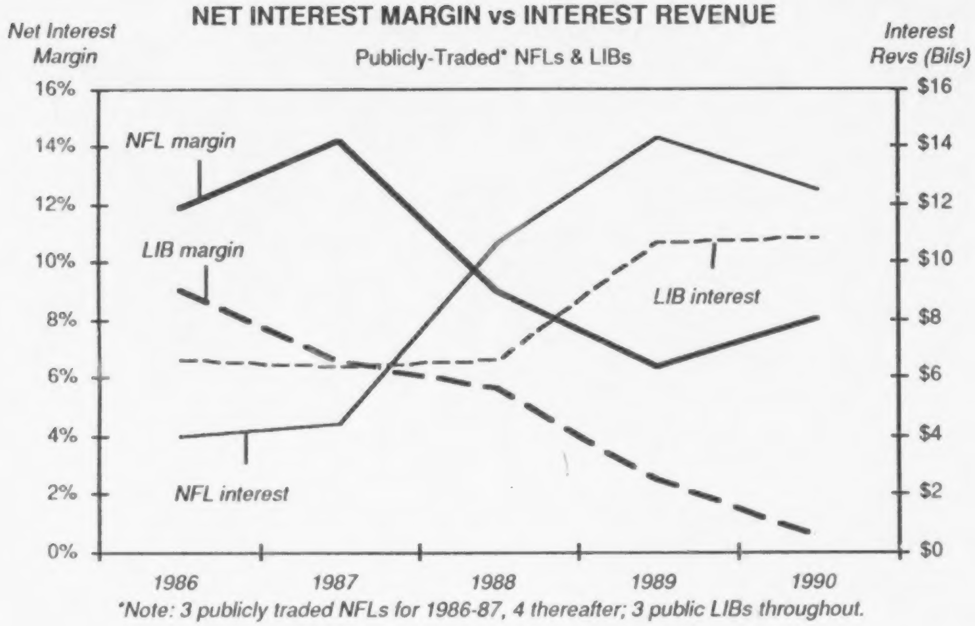
*First Half Annualized

Of course, charging off gross interest expense without crediting the contra side of the equation, interest revenue, can unfairly distort one's analysis of cost control measures or profitability. For just this reason, many firms accurately decide to report their interest net of expenses as a revenue line on their P&L. Unfortunately, FOCUS reporting does not allow for this analysis.

Net Interest Income

However, If we look at the P&Ls of four publicly held NFLs (three prior to 1987) and three public LIBs, we see that, with the notable exception of 1989-90 for one investment bank, all firms consistently reported net interest income. On the other hand, as the industry has become more and more capital intensive and built up huge inventory and deal financing costs, interest expense exploded along with interest revenues and reduced the marginal returns earned from net interest income. As these publicly held NFLs' interest revenues and costs exploded (Exhibit 12), their margin of net interest income to total interest revenue fell from about 14% to 6% last year. As interest revenues and costs retreated in 1990 (annualized), the margin rebounded somewhat to 8%. Similarly, as the three LIBs' interest exploded, the marginal return declined to under 1% this year (although this is dragged down by huge net interest costs of one LIB). It should be noted that although Exhibit 12 shows the publicly-held NFLs with higher gross interest data than the publicly-held LIBs, the complete LIB group has much higher aggregates than the NFLs in total (but the marginal return trends should be similar for all).

Exhibit 12



*Note: 3 publicly traded NFLs for 1986-87, 4 thereafter; 3 public LIBs throughout.

Higher Profit Margins

Nevertheless, net interest income is still a positive to the bottom line of most firms and a large one at that, despite shrinking margins. For comparative purposes, Exhibit 13 shows the pre-tax profit margins of groups of firms during the past 10 years two different ways: with either gross interest revenue or net interest revenue included in the divisor. Only the LIBs, with their heavy capital markets and interest commitment, have a significant variance when calculating profit margins both ways (Exhibits 13 and 14). The LIBs' profit margin using net interest income is about double the FOCUS Report measurement (gross interest revenue included in the denominator), which further emphasizes this group's significantly higher profitability than other firms in the industry. Since the LIBs are such a large factor in industry aggregates, the total industry profit margin variance is also exacerbated by the LIBs' heavy weighting. The NYCs hava also mirrored the LIBs' performance here the past few years.

Exhibit 13

PRE-TAX PROFIT MARGINS
(In Percent)

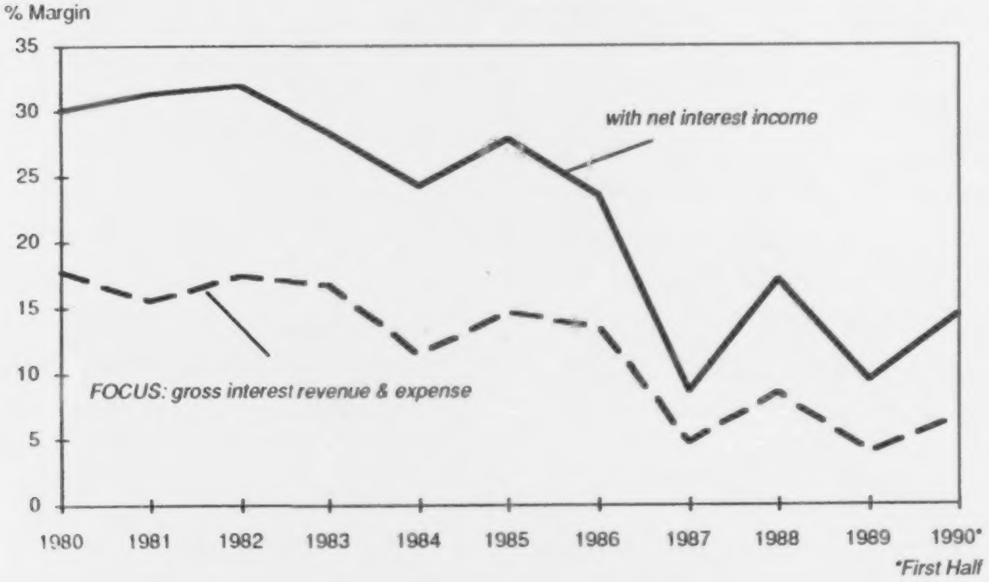
Firm Category	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990*
National Full Line Firms	10.9	6.9	8.8	8.6	(0.9)	5.6	6.9	(0.9)	(0.3)	(0.1)	(5.2)
Large Investment Banks	17.7	15.4	17.4	16.7	11.4	14.6	13.5	4.7	8.4	3.9	6.4
Regionals	14.7	11.1	11.1	12.6	2.6	9.4	11.0	5.5	2.6	4.4	(0.4)
New York City Based	14.7	12.6	14.0	18.3	8.9	12.2	16.1	2.9	7.4	4.2	1.6
Discounters	17.5	12.2	13.6	14.0	0.3	6.9	15.7	8.6	3.1	7.2	7.3
All NYSE Firms	**14.1**	**10.8**	**13.1**	**12.9**	**5.2**	**10.7**	**11.0**	**2.2**	**4.8**	**3.1**	**0.8**

PRE-TAX PROFIT MARGINS, LESS INTEREST EXPENSE
(In Percent)

Firm Category	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990*
National Full Line Firms	13.0	8.8	10.3	9.9	(1.2)	6.9	8.5	(1.1)	(0.4)	(0.2)	(6.8)
Large Investment Banks	30.0	31.3	31.8	28.3	24.1	27.7	23.4	8.5	17.1	9.4	14.4
Regionals	16.4	13.2	12.5	13.7	3.0	10.4	11.6	5.9	2.8	4.9	(0.5)
New York City Based	18.8	16.5	16.8	21.5	11.1	14.1	20.7	4.4	13.2	11.8	4.7
Discounters	17.9	13.3	15.4	15.5	0.4	10.5	18.2	9.9	3.9	9.4	9.6
All NYSE Firms	**18.0**	**15.2**	**17.1**	**16.3**	**7.4**	**14.5**	**14.6**	**3.1**	**7.0**	**5.2**	**1.3**

Exhibit 14

LIBs' Pre-Tax Profit Margin



**First Half*

Compensation Costs

On the expenditure side of the industry's P&L, the industry's largest non-interest expense is compensation. Total compensation is down to a third of all expenses this year from 41% in 1987, including gross interest expense. With the escalating gross interest expense netted out, however (as most firms do beyond their FOCUS filings), compensation is still a whopping 57% of total costs, about even with 1987's 58%. Nevertheless, total compensation costs are running 2% below last year's level based on first half results annualized. For most of the industry, the progress in reducing compensation costs is actually much better than this 2% figure would indicate.

If we split the industry into the 10 largest capitalized firms, "Top 10," and then everybody else, "all other firms," we find that, except for the Top 10, the industry has been doing an excellent job of cost reduction. Registered representative compensation (which is almost entirely RR payout in most FOCUS filings) at the non-10-largest firms is running about 6% below last year's level. This is in line with this group of firms' 7% drop in commission revenue. With an overall industry drop of 11% in commission revenue so far this year, the non-largest firms' smaller 7% drop-off is impressive. The strategy of trimming lower-end producers from staff is paying off — the non-largest firms pared back their average RR workforce 9% in this year's first half compared to all of last year with, as mentioned, a smaller 6% drop in overall production.

Problems at the Top

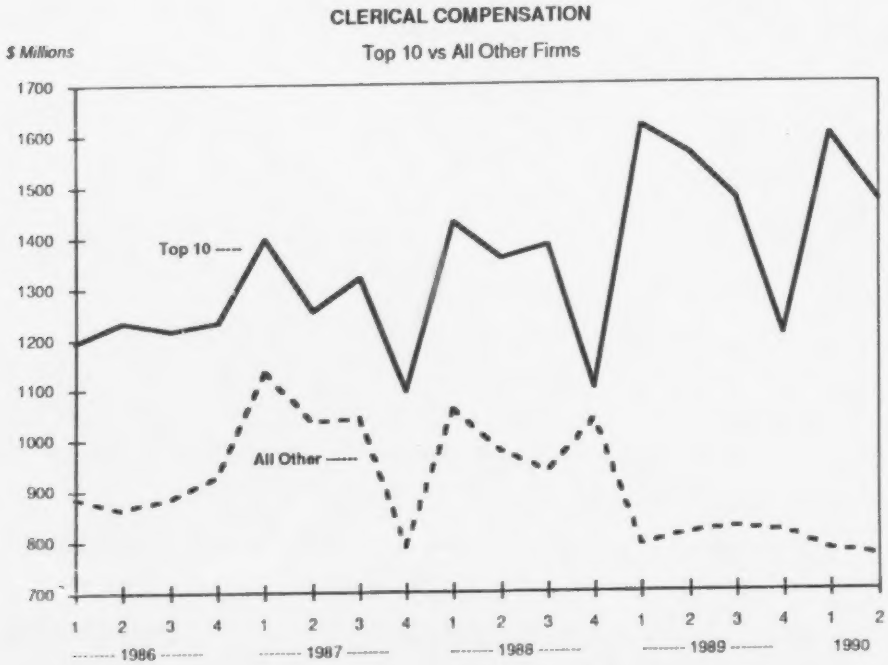
At the Top 10 firms, particularly the largest wirehouses, the reverse was true. The Top 10's commissions fell nearly 16% while RR compensation fell only half that rate, 8%. The NFLs, alone, had an 18% drop in commissions with half that drop in RR compensation. Further, both the Top 10's average RR employment in the first half is down less than 5% from last year's average, while production fell three times that rate. At the wirehouses, gross commissions are down 18% and average RR employment is down just under 10%.

Crediting total revenue from mutual fund sales on top of commissions would temper the comparison somewhat, but even here the NFLs' performance badly trails all other firms. The NFLs had only an 8% growth of mutual fund revenue in 1989 and a 10% growth rate this year (annualized) while all other firms' growth was 25% and 33%, respectively.

Higher Compensation

The 10 largest firms (by capital), particularly the largest wirehouses, have obviously not done as good a job as the rest of the industry in yielding higher production from a smaller group of higher-end producers, but this is not surprising. The Top 10 firms have typically employed from 50% to 60% of all RRs in the industry while generating less than half the industry's commission revenues. Looking at the wirehouses, alone, we find that they still employ 61% of all RRs from a year before the crash and for every year since right up until today, despite the shrinking workforce and the loss of three NFLs — E.F. Hutton, Thomson McKinnon and Drexel. Meanwhile, their share of industry commissions has now shrunk to below 40% of the total. And though they still dominate the mutual fund sales arena, their share of this revenue base fell from 77% in 1988 to just 70% this year.

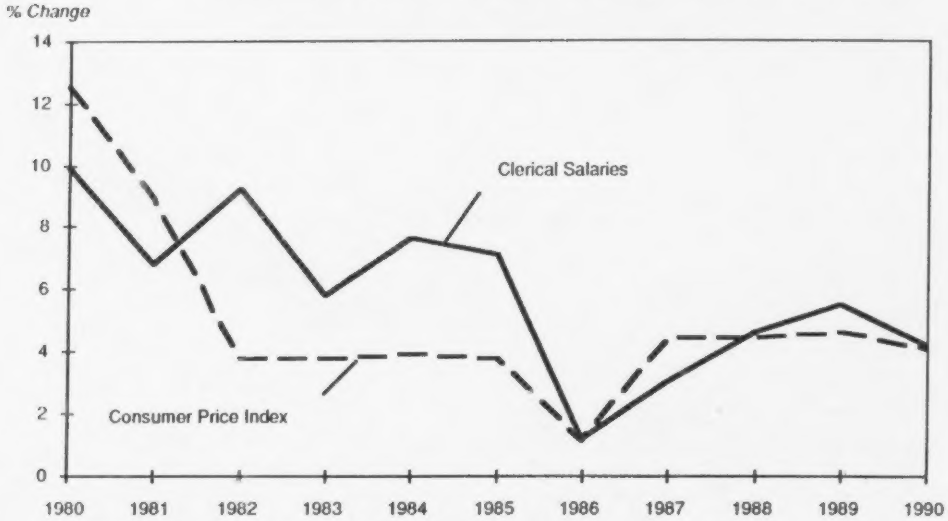
Exhibit 15



Where the Top 10 firms show the most divergence from the rest of the industry's compensation trend is on the non-producer side. Exhibit 15 shows the FOCUS "clerical compensation" line for the Top 10 firms and everyone else combined. The non-largest firms have shown a pretty much downward sloping clerical cost trend since the record high in 1987's first quarter, also the record high quarter for industry profits. This group is showing an additional 5% reduction in clerical compensation costs so far this year on a non-producer workforce that is, on average, 8% below last year's level. The steadily lower expense is particularly laudable since firms still have had to grant increases (albeit lower in recent years) to their remaining clerical workforce to maintain real inflation-adjusted paychecks (Exhibit 16) and to remain competitive in the job market. Further, securities firms have faced the same personnel cost increases as other industries, i.e. medical benefit costs which have doubled or tripled the past few years.

Exhibit 16

SECURITIES INDUSTRY CLERICAL SALARIES vs CPI



Source: SIA Reports on Production & Earnings of RRs

The 10 largest firms continue to see their "clerical compensation" cost line rise as their non-producer workforce decreases. Why? Several CFOs of these firms explain that their "core" clerical workforce, i.e. operations, secretaries, etc., have witnessed the same cost reductions as the rest of the industry. Where increases have occurred in the non-producer labor force, it has mainly been in some high pay scale areas. Several large firms have been building their technology areas, particularly firm-wide workstations which have created a big demand for some very competitive and high-paying technology professionals. Also, they explain that the cutbacks in clerical staff have been concentrated in the lowest paying areas in operations while high-end scale areas, such as legal and compliance, are not being trimmed and in fact may need to be bolstered.

The large firms have the same cost pressures as the rest of the industry also, such as the COLAs and medical costs, but have one large additional cost in this line which is concentrated among these firms — traders and investment bankers. Much of the traders' and investment bankers' compensation is lumped into the clerical compensation line, and these personnel are concentrated at the larger firms. In fact, in the case of higher clerical compensation, it is the Large Investment Banks, and not the NFLs, which have shown the cost increases. The heavy Q1 spike-ups in Exhibit 15 was attributed to FOCUS filers predilection for lumping firm-wide bonuses and accruals into the clerical line. Still, recent announcements of further staff cuts at the LIBs, particularly investment bankers, may help drive this cost line down in the future.

The Good News - Other Expenses

As promised earlier, we saved the good news to last. All other expenses for the industry in 1990 (first half annualized), except for non-recurring charges associated with downsizing (from large NFLs), are running below last year's levels. As Exhibit 17 shows, compensation, as mentioned, as well as communications and promotional costs are all running more than 2% below 1989 levels. Error account losses are down 20% from 1989 while gross interest expense, floor costs and regulatory fee expenses are all down 7%. Occupancy & equipment costs are also down 4%.

The NFLs' cost cuts mirror the industry's cuts in direction, down, but have substantially higher percentage movements. For instance, floor costs, promotional expenses, EDP and regulatory fees were all down about 12% to 13%.

The LIBs also showed a drop in most expenses but showed a 33% rise in error accounts (although the total costs here are minimal), and they still showed a 3% rise in occupancy costs despite the substantial softening in the commercial real estate market over the past few years. Overall, total expenses are down 5% industry-wide; down 7% and 8% at the NFLs and LIBs, respectively. Regional and NYC-based regionals, each showed a 3% rise in expenses so far this year (first half annualized), but this is substantially below prior-year cost increases. Discounters, meanwhile, showed a 13% cost boost but alongside a revenue base which grew as fast.

Exhibit 17

NYSE BROKER-DEALER INCOME STATEMENT

(In $ Millions)

REVENUE:	**1989**	**1H90A**	**89 - 90 % Change**
Commissions	10,150.7	9,057.4	-10.8%
Trading Gains	12,343.3	13,592.0	10.1%
Investment Gains	488.1	-77.2	-115.8%
Underwriting Revenue	4,120.0	3,507.8	-14.9%
Margin Interest	3,723.1	3,160.8	-15.1%
Mutual Fund Sales	1,579.5	1,831.4	15.9%
Fees, Account Supervision	2,225.8	2,245.0	0.9%
Research	27.1	16.0	-41.0%
Commodities	1,407.6	1,862.2	32.3%
Other Securities Related	20,337.5	17,510.0	-13.9%
Other Unrelated	3,134.4	2,633.4	-16.0%
TOTAL REVENUE	59,537.1	55,338.8	-7.1%
EXPENSES:			
Total Compensation	18,825.8	18,400.0	-2.3%
RR Compensation	7,539.3	7,009.8	-7.0%
Clerical Compensation	9,103.2	9,211.2	1.2%
Floor Costs	1,855.4	1,724.6	-7.0%
Communications	2,374.2	2,312.0	-2.6%
Occupancy & Equipment	3,163.3	3,040.2	-3.9%
Promotional Costs	954.6	933.2	-2.2%
Interest Expense	24,069.8	22,478.6	-6.6%
Errors, Bad Debts	421.8	336.8	-20.2%
EDP	710.7	676.8	-4.8%
Regulatory Fees	437.5	405.0	-7.4%
Non-Recurring Charges	239.8	528.6	120.4%
Other	4,642.2	4,061.4	-12.5%
TOTAL EXPENSES	57,695.1	54,897.2	-4.8%
PRE-TAX NET INCOME	1,842.0	441.6	-76.0%

Source: SIA's Securities Industry DataBank

Conclusion

In sum, the industry is beginning to show progress in reducing its costs, particularly compensation costs, but plenty of problems remain, mostly from industry-bred practices. As we mentioned in our May issue of *Trends*, some of the problem compensation practices employed in the industry are a holdover from the partnership era, such as firm-wide bonuses not proportionate to profits, or even granted during periods of losses. Although long-standing practices are now being changed, some firms still make payments to both profitable and unprofitable departments on the premise that business cycles will even this out in the end, which may not happen.

Incentive compensation is still revenue-oriented, not profit-oriented. Compensation is often irrational: systems or secretarial personnel working for capital markets are compensated vastly greater than the same functionaries in operations, even though they perform the same function. Besides being an unnecessary expense to a firm's overall budget, this practice has exacerbated internal strife between retail and capital markets personnel.

And finally, firms keep paying high producer compensation in order to not lose high producers to the competition. However, the higher compensation often applies to lower-end producers as well. A steeper sliding scale, or a profit-measured scale, would better suffice. Although these problems are being widely discussed, they are not being adequately addressed yet. However, the magnitude of the industry's problems over the past three years of industry recession would have been a challenge to any management.

George R. Monahan
Director of Industry Studies

UNDERWRITING

	OCTOBER 1990	OCTOBER 1989	% CHANGE 1990-1989
CORPORATE FINANCING (Gross New Issues - $ Mils)			
TOTAL	$22,365.7	$35,934.7	-37.8%
Common Stock	$396.8	$2,593.0	-84.7%
# of Common Stock Issues	12	48	-75.0%
Preferred Stock	$375.0	$780.0	-51.9%
# of Preferred Stock Issues	7	9	-22.2%
Corporate Debt	$21,593.9	$32,561.7	-33.7%
# of Corporate Debt Issues	95	132	-28.0%
MUNICIPAL FINANCING (Gross New Issues - $ Mils)			
Negotiated	$4,690.8	$7,121.0	-34.1%
# of Issues	255	423	-39.7%
Competitive	$2,964.1	$3,058.1	-3.1%
# of Issues	280	307	-8.8%

Source: Securities Data Co.

PRICES
(END OF MONTH)

	OCT. 1990	OCT. 1989	% CHG OCT. 1990-1989
DOW JONES INDUSTRIALS	2442.33	2645.08	-7.7%
STANDARD & POOR'S 500	304.00	340.36	-10.7%
NYSE COMPOSITE	166.17	188.24	-11.7%
AMEX MARKET VALUE INDEX	287.79	370.58	-22.3%
VALUE LINE COMPOSITE	179.60	258.05	-30.4%
NASDAQ COMPOSITE	329.84	455.63	-27.6%

YIELDS
(MONTHLY AVERAGES)

	SEP. 1990	SEP. 1989	BASIS POINT CHG 1990-1989
BOND BUYER INDEX (20 BOND)	7.53%	7.26%	27
CORPORATE BOND YIELDS (MOODY'S)			
Aaa CORPORATE	9.56	9.01	55
Baa CORPORATE	10.64	9.91	73
RATIO Aaa CORPS. TO Baa CORPS.	0.90	0.91	(1)

VOLUME

	SEP. 1990	YTD 1990	SEP. 1989	YTD 1989	% CHG YTD 1990-1989
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	141.3	156.8	151.8	166.1	-5.6%
AMEX (MILS.)*	11.7	13.8	12.6	12.2	13.1%
NASDAQ (MILS.)*	110.3	136.0	131.3	132.5	2.6%
REGIONAL EXCHANGE (MILS.)*	20.9	24.7	24.5	26.5	-6.8%
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	$82,787	$1,026,714	$120,174	$1,165,773	-11.9%
AMEX (MILS.)	2,562	30,218	3,977	32,295	-6.4%
ODD-LOT SHARES PURCHASED ON NYSE (THOUS.)	7,530	89,522	9,255	88,771	0.8%
ODD-LOT SHARES SOLD (INCLUDING SHORT SALES) ON NYSE (THOUS.)	10,932	128,776	15,336	155,630	-17.3%
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	48.4%	49.7%	49.0%	51.6%	----
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	9,777	98,191	9,688	97,368	0.8%
AMEX OPTIONS	2,742	26,887	3,740	31,033	-13.4%
COMMODITY	20,488	210,647	19,888	204,497	3.0%

*MONTHLY AVERAGE
N/A - DATA NOT AVAILABLE

RECENT INTERESTING READING AND STATISTICAL MATERIAL

Item	Description	Source
SIA Fact Book -- The Securities Industry of the Eighties	Fact Book designed to provide a decade of data on the most frequently asked questions on the securities industry and capital markets. In 31 pages of tables and charts, the book covers various aspects of the securities industry including: the brokerage community, capital markets, stock market activity, mutual funds, futures and options, retail and institutional trading and holdings, economic data and vital foreign market statistics.	SIA Research Department Members: $25; Others: $50
"Desperate Hours... From Congress Some Late Changes in Taxes, Spending"	Quick look at the largely overlooked budget provisions affecting taxation of securities and transactions involving junk bonds and leveraged buyouts and review of basic tax changes. Notes that although many people thought that the purpose of the annual budget exercise was to cut spending as well as to raise taxes, only defense registers an actual spending reduction in the first year -- $29 billion less than in fiscal 1990. There aren't any other spending cuts in the whole 5-year package, only reductions from previously approved program levels, adjusted upward for inflation. In fact, for every new dollar in taxes raised during the 5 years, federal spending is to rise $1.90.	Barron's November 5, 1990
"Investment Management in the 1990s"	Author Arthur Zeikel's view of the future. Notes two trends which will dominate investment management activity: 1. Investing around the world is a true growth business. The nature of the growth, however, will engender increased competitive pressures for most organizations. 2. The appetite for and appeal of owning individual securities has sharply declined and will continue to do so.	Financial Analysts Journal September/October 1990

Item	Description	Source
"Redefining Strategies for the 90s"	Three views of what will work in the "maturing" securities industry. 1. Downsizing or rightsizing stresses what firms need to know before making changes -- the numbers and what they mean, the firm itself, the competition and the risks. 2. What the customer wants reviews the new needs of the institutional customer. 3. From profit drain to management tool makes the case for treating bonuses as capital.	Investment Dealers' Digest October 29, 1990
"The Sheikhs of Wall Street"	Author writes that control of the oil-price mechanism has changed hands once again. Over the last decade U.S. investment banks, with an appetite for risk far greater than the traditional players, quietly have carved a niche for themselves in the industry. Their entry has coincided with a profound change and these banks are seen to have the capacity to move markets and trade as much as the major companies.	Euromoney October 1990
"Can John Reed Rock Citicorp Out of Its Rut?"	Bad loans, thin reserves, and a worried Wall Street are leaving John Reed a lot less room to maneuver. Article chronicles bank's problems and strategy for dealing with them. Reed is reviewing existing businesses with a view to selling off or closing poor performers. Staff cutbacks are already under way, and by the end of 1991, Citibank will trim its payroll by at least 2,000.	Business Week November 12, 1990
"Last one out of Gotham, close the door"	The Economist takes a look at recent developments in NYC. Finding: New York looks set to survive, even prosper -- if it can slow the exodus of its middle class. The roots of some city problems are national, not local, and are beyond the capacity of the city to contain, let alone cure. More money would help somewhat but New Yorkers are among the most heavily taxed people in the U.S.	The Economist October 20, 1990

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Securities Industry

TRENDS

An Analysis of Emerging Trends in the Securities Industry
Produced by the SIA Research Department

Vol. XVII, No. 1

April 5, 1991

Securities Industry Posts First Annual Loss Since 1973

Highlights

1. Last year was the worst on record for the securities industry – NYSE member firms reported a record annual pre-tax loss of $162 million for full-year 1990. Since records became available in 1965, the only other reported annual loss for the industry was back in 1973, a $72 million pre-tax loss. For the National Full Line firms, the bite was even worse last year: a record $678 million pre-tax loss.

2. The annual loss was widely expected and hardly surprising – NYSE member firms reported aggregate losses in four of the past five quarters. The string of losses began with 1989's fourth quarter pre-tax loss of $92 million followed by a 1990 first quarter loss of $487 million. The only profitable quarter last year, Q2, showed $708 million in pre-tax net income; followed by losses of $189 million in Q3 and $194 million in Q4.

3. In just over a year's time, the industry's equity capital base shrank by $4 billion or 15% from a record $27.1 billion in 3Q89 to $23.0 billion by 4Q90. This equity base is the smallest since 1986. Further, total capital (equity plus subordinated debt) fell 9% last year from a record $39.3 billion at year-end 1989 to $35.8 billion at year-end 1990, the lowest level since the 1987 crash.

4. Securities industry employment has contracted 20% since the crash, from 262,000 to 210,000; this is the lowest industry workforce since 1984.

5. Commission revenues declined each quarter throughout the year finishing at a mere $2 billion in the fourth quarter. This is the same level of commission revenues earned from late 1982 to early 1984. For the year, total commissions of $8.9 billion were down 13% from 1989, and a sharp 30% below 1987's peak.

6. Although partly due to the shrinkage of the number of firms in the industry, securities firms, almost universally, showed across-the-board expense cuts last year. NFLs and Large Investment Banks had expense cuts of 11% and 9%, respectively; Regionals managed a 5% decline; Commission Introducing firms had a 6% cut, while unclassified firms showed cuts of 3%.

Securities Industry Association

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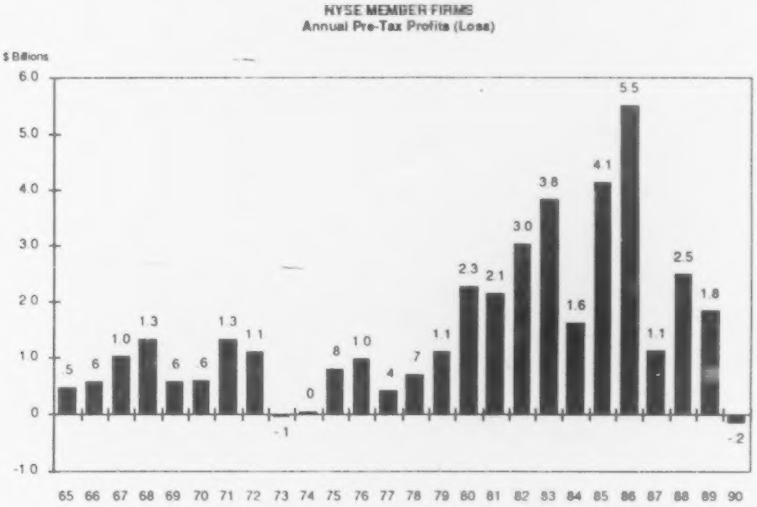
Introduction — Worst Year on Record

For the four out of five securities industry professionals still employed in the industry three full years since "the crash," February appeared to be finally that bright light at the end of the long, dark tunnel. March came in like the proverbial lion also, and didn't exactly go out like a lamb. Of course, since official fourth quarter data was only now released, the full story will have to wait until around Memorial Day, when 1Q91 data should first become available.

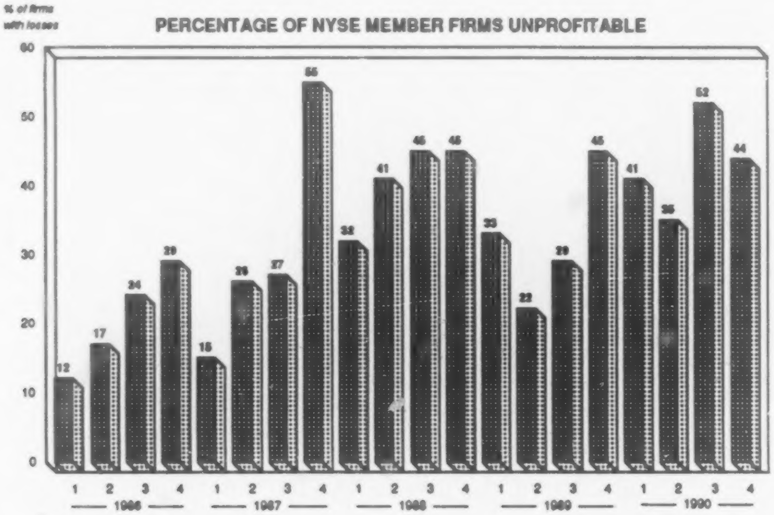

NYSE MEMBER FIRMS
Annual Pre-Tax Profits (Loss)

Despite this first, in a long while, slightly bullish opening, a reflection on the year just past catapults us back to the more sobering period of the industry's three years of recession. Last year was, in fact, the worst on record for the securities industry. New York Stock Exchange (NYSE) member firms dealing with the public[1] reported a record annual pre-tax loss of $162 million. For the 10 largest firms, however, the bite was even worse: a record $574 million loss pre-tax.

---

[1] NYSE member firms dealing with the public number only about 330 but, because of the heavy concentration of the largest firms among this group, the NYSE group accounts for about 90% of the securities business conducted by the 5,800 members of the National Association of Securities Dealers (NASD) and 80% of the business conducted by the approximately 9,000 firms registered as broker-dealers with the Securities and Exchange Commission (SEC). Unless otherwise noted, references in *Trends* to "total industry" or "securities industry," refer to the NYSE group. Data for the NYSE group and subcategories of firms, is available quarterly and annually from SIA's *Securities Industry DataBank*.

Since records became available in 1965, the only other *annual* loss reported for the industry was back in 1973 – $72 million. The 1990 loss was widely expected and hardly surprising – NYSE member firms have reported aggregate losses in four of the past five quarters and one-third to one-half of these members have consistently posted red ink each quarter since the "crash." With these continuous losses, it is hardly surprising that the universe of securities firms continues to shrink from closings and mergers. The number of NYSE member firms dealing with the public, which account for 80% of all the securities business conducted in the U.S., fell to around 330 firms at year-end 1990, the lowest ever since records were kept. NASD membership at year-end 1990, at around 5,800, is the lowest since 1984.



The string of losses began in the final quarter of 1989 with an industry-wide pre-tax loss of $92 million. This loss was entirely attributable to fourth quarter "non-recurring" charges of $191 million posted by the National Full Line Firms (NFLs)[2] and associated with write-offs from their downsizing to haul in costs. Without this, the quarter would have shown an industry-wide $100 million profit.

---

[2] The NFLs are the largest full service brokerage firms (also known as "wirehouses") with an extensive national and international branch network system. This group, one of the various selection of firm categories available on the *Securities Industry DataBank*, accounts for the vast majority of the U.S. securities industry's retail brokerage services, revenues and employees. These firms, currently numbering seven, provide a broad array of virtually every financial service and product to both households and institutions. With one exception, all are headquartered in New York City. Also, their investment banking businesses are comparable to those of the "Large Investment Banks" (LIBs). Further information, as well as quarterly Income Statements and Balance Sheets, for the NFLs, LIBs, Regionals, Discounters, and other firm categories, are available on SIA 's *Securities Industry DataBank* (contact SIA Research Department).

INCOME STATEMENT
NYSE Member Firms Doing a Public Business
(In $ Millions)

	1989	1990	$ Change	% Change
REVENUE:				
Commissions	10,150.7	8,878.1	-1,272.6	-12.5%
Trading Gain	12,343.3	13,175.0	831.7	6.7%
Investment Account Gain (Loss)	488.1	-283.1	-771.2	-158.0%
Underwriting Revenue	4,120.0	3,243.3	-876.7	-21.3%
Margin Interest	3,723.1	3,075.3	-647.8	-17.4%
Mutual Fund Sale Revenue	1,579.5	1,669.1	89.6	5.7%
Fees, Asset Management	2,225.8	2,241.0	15.2	0.7%
Research Revenue	27.1	18.4	-8.7	-32.1%
Commodities Revenue	1,407.6	1,685.8	278.2	19.8%
Other Related to Securities Business	20,337.5	17,389.3	-2,948.2	-14.5%
Other Unrelated	3,134.4	2,941.5	-192.9	-6.2%
TOTAL REVENUE	**59,537.1**	**54,033.7**	**-5,503.4**	**-9.2%**
EXPENSES:				
Compensation	18,825.8	17,715.2	-1,110.6	-5.9%
Floor Costs	1,855.4	1,731.0	-124.4	-6.7%
Communications	2,374.2	2,221.7	-152.5	-6.4%
Occupancy & Equipment	3,163.3	3,092.2	-71.1	-2.2%
Promotional Costs	954.6	878.4	-76.2	-8.0%
Gross Interest Expense	24,069.8	22,717.2	-1,352.6	-5.6%
Error Account Losses & Bad Debts	421.8	296.3	-125.5	-29.8%
EDP Costs	710.7	684.6	-26.1	-3.7%
Regulatory Fees & Expenses	437.5	427.7	-9.8	-2.2%
Non-Recurring Charges	239.8	389.5	149.7	62.4%
Other	4,642.2	4,041.7	-600.5	-12.9%
TOTAL EXPENSES	**57,695.1**	**54,195.5**	**-3,499.6**	**-6.1%**
PRE-TAX NET INCOME	**1,842.0**	**-161.8**	**-2,003.8**	**-108.8%**
PRE-TAX PROFIT MARGIN	3.1%	-0.3%		
PRE-TAX R.O.E	6.9%	-0.7%		

The very next reporting period (1Q90), these "non-recurring" charges recurred. The NFLs continued their net write-offs, totaling $259 million, which again accounted for the bulk of the industry's $487 million quarterly red ink.

A One Quarter Earnings Respite

The only respite from the string of quarterly losses came in 2Q90. The $708 million pre-tax profit posted that period was largely due to the notable absence of any further write-offs. The respite was short lived. The third quarter's post-Kuwait market slide wreaked havoc on firm's securities inventories and led to dried up investor participation. The resultant markdowns of securities to lower market values at September's close and declining investor activity led to another industry loss, $189 million pre-tax, this time distributed among more firms than just NFLs. Specialists, trading and clearing firms, as a group, took enormous write-offs in investments for their own accounts, about $250 million, with equal bottom line losses and similarly sized mark-downs in their investments in affiliates on the balance sheet. The fourth quarter witnessed another resurgence of industry losses, $194 million pre-tax, driven, mainly, by much higher losses at the largest firms – $186 million at the NFLs and $215 million at the LIBs.

NFLs' Woes Continue to Dominate Industry Losses

For the full year also, the industry's $162 million loss was entirely attributable to the NFLs. The NFLs posted a record annual pre-tax loss of $678 million, which was the fourth consecutive annual loss for this group of national retail broker-dealers. The Large Investment Banks managed a pre-tax profit of only $426 million, their lowest annual showing since 1979.

SECURITIES INDUSTRY PROFITABILITY RATIOS

PRE-TAX PROFIT MARGIN
(In Percent)

Firm Category	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
National Full Line Firms	10.9	6.9	8.8	8.6	-0.9	5.6	6.9	-0.9	-0.3	-0.1	-3.9
Large Investment Banks	17.7	15.4	17.4	16.7	11.4	14.6	13.5	4.7	8.4	3.9	2.4
Regionals	14.7	11.1	11.1	12.6	2.6	9.4	11.0	5.5	2.6	4.4	0.4
NYC-Based Regionals	14.7	12.6	14.0	18.3	8.9	12.2	16.1	2.9	7.4	4.2	1.1
NYSE Discounters	17.5	12.2	13.6	14.0	0.3	8.9	15.7	8.6	3.1	7.2	5.8
All NYSE Firms	**14.1**	**10.8**	**13.1**	**12.9**	**5.2**	**10.7**	**11.0**	**2.2**	**4.8**	**3.1**	**-0.3**

PRE-TAX RETURN ON EQUITY
(In Percent)

Firm Category	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990
National Full Line Firms	45.0	24.6	29.7	28.1	-2.6	17.9	20.3	-2.1	-0.7	-0.3	-8.3
Large Investment Banks	55.7	56.7	54.8	43.8	31.1	38.5	34.2	9.2	18.2	9.2	5.4
Regionals	N/A	37.2	36.0	40.5	6.8	29.0	32.7	14.0	5.4	10.4	1.0
NYC-Based Regionals	N/A	42.1	43.3	50.7	19.9	31.2	38.3	5.2	15.0	11.4	3.1
NYSE Discounters	N/A	52.2	53.9	46.8	0.8	25.6	49.5	19.7	5.0	14.5	15.4
All NYSE Firms	**49.2**	**35.9**	**40.5**	**36.6**	**13.3**	**29.4**	**28.6**	**4.7**	**9.6**	**6.9**	**-0.7**

Regional firms, while finishing 1990 with a $32 million Q4 profit after two quarters of losses, still had only a marginal profit of $19 million pre-tax, for the full year, their poorest showing since data became available in 1980. In fact, all groups[3], except Discounters, had their poorest showing on record last year. New York City-Based Regionals and Commission Introducing firms had their smallest profits since records were kept beginning in 1980, while all other firms (not categorized) showed their first annual loss ever as a group.

The NYSE Discounters were the only group of firms not to post a disaster year in 1990; they were also the only group to escape any quarterly losses. Further, the NYSE Discounters' 1990 annual $84 million pre-tax profit would have been much higher if not for Q4's post Kuwait drought in the commission business. Moreover, before Saddam's invasion unnerved investors, Discounters already had $80 million in profits booked (Q1 through Q3) and were headed for their second best year ever.

In fact, much of the Discounters', the NFLs', and the industry's, fourth quarter problems were directly related to investor confidence, or the lack thereof. With investors clearly upset over an announced economic recession, impending war, gyrating oil prices, and crashing bank stocks, commission revenue continued its 1990 quarterly descent, finishing the year with a mere $2 billion posted in Q4. That's the same level of commission business done quarterly from late 1982 to early 1984. For the year, total commissions of $8.9 billion were down 13% from 1989, and 30% below 1987's peak. Commissions also fell to only 15.5% of total revenues in 4Q90.

The NFLs alone, which account for $2 out of every $5 commission dollars earned in the industry, saw their 4Q90 commissions plummet 17% from the previous quarter to under $750 million. This level is merely half of 1Q87's tally for this group, though E.F. Hutton and Thomson McKinnon have merged into other firms in the group since then and Drexel is gone. The latest round of top producing broker wars is an attempt to boost these depressed levels in the current upswing environment, though this tactic usually proves to be very costly in the long run.

February's "Best" Volume Ever

As mentioned, 1991 has gotten off to an excellent start. NYSE average daily volume in 1Q90 is up 26% over the previous quarter (see chart) and February's average daily volume of 227 million shares was the second highest monthly average ever. Considering that the record month, October 1987 (277 million), was built on 600 million share days during crashing markets, February 1991, a *rising* market, is the *best* month ever and many firms have confirmed that it was their best February for the bottom line, even with very slow capital market activity. As the chart below indicates, 1Q91 should show vastly improved industry profitability.

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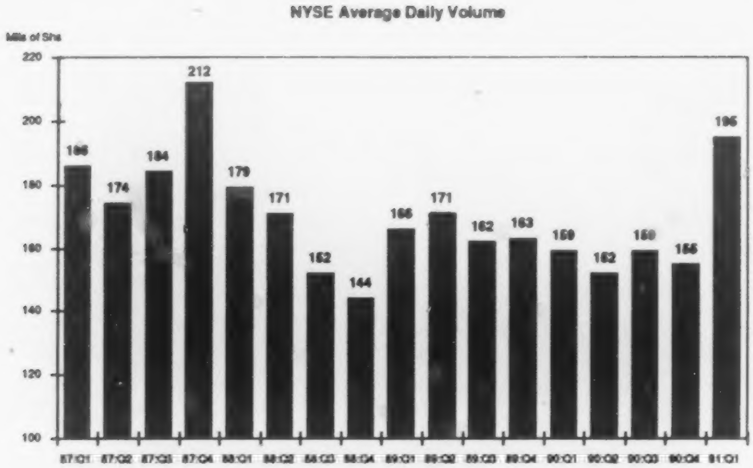
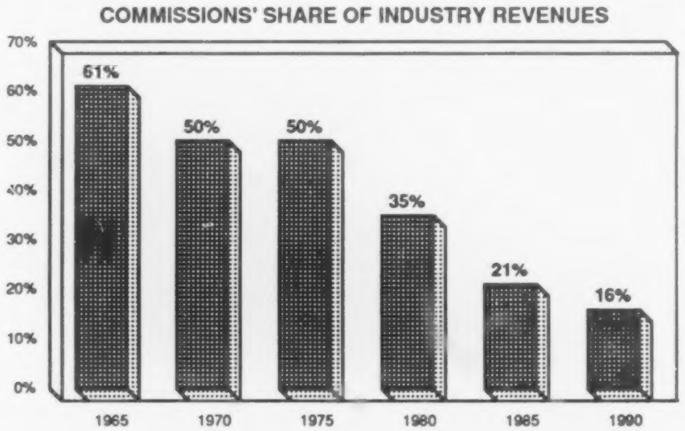
[3] This issue of *Trends* focuses on trends within the securities industry in aggregate. The next issue of *Trends* (May 1991) will analyze these categories of securities firms in more detail.



Still, commissions continue to play a less significant role in the overall revenue picture of the securities industry. Last year, only 16% of total revenues came from the commission business. This was also on a smaller revenue base last year – $54.0 billion, which was $5.5 billion, or 9%, below 1989's record level of $59.5 billion.



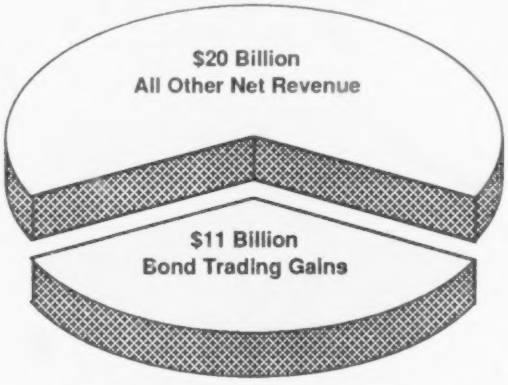
The trend of firms using crossing networks for more and more of their listed equity business is also supported from the 1990 commission revenue results. Agency commissions from sales of listed equity executed away from an exchange skyrocketed 71% last year to a record $147 million, supporting articles showing a trend towards trading being done away from the primary markets.

Principal Businesses

For last year's principal trading, net gains from all trading accounts increased $832 million, or 7%, to a record $13.2 billion. But the year-to-year increase was not equally felt at all firms. Investment banking-oriented firms, such as the Large Investment Banks and the New York City-based Regionals, showed large increases while retail-oriented firms, such as Regionals and the NFLs, showed declines from 1989 levels. In fact, the LIBs' 22% increase in trading gains amounted to a net increase of $832 million, exactly matching the increase for the industry as a whole.

Bond trading, of course, accounts for the vast majority of all trading account gains despite the media's fixation on the equity side such as index arbitrage, risk arbitrage, etc. Last year, 84% of all trading gains came from fixed income, up from 70% the previous year and 60% a decade ago. Bond trading gains, in fact, jumped nearly 30% in 1990 to a record $11 billion, and accounted for 20¢ out of every $1 in total revenue booked; a record share. Furthermore, net of interest, fixed-income trading gains accounted for a record 35¢ out of every $1 of net revenue.

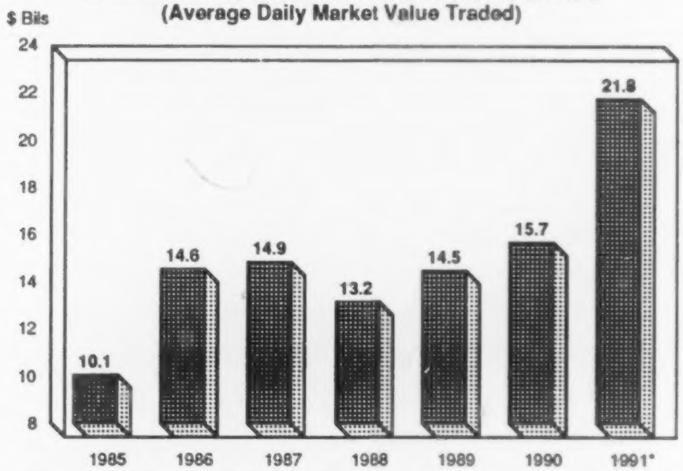
SECURITIES INDUSTRY 1990 NET REVENUE
(Net of Interest Expense)



Source: Securities Industry DataBank

The Federal Reserve Board's easing of interest rates begun last summer and continuing into 1991 sent the value of bonds, and the value of trading, skyward. Also helping was the concurrent investor shift of funds from equities to fixed income instruments after the Kuwait invasion in early August. SIA's Investor Activity Report shows that institutional secondary trading of corporate bonds last year reached a record level since data began in 1985. The continued Fed easing in early 1991 led to heavy increases in bond trading. Though debt trading gains are from both corporates and governments, the chart is indicative of the heavy activity in last year's fixed income secondary market.

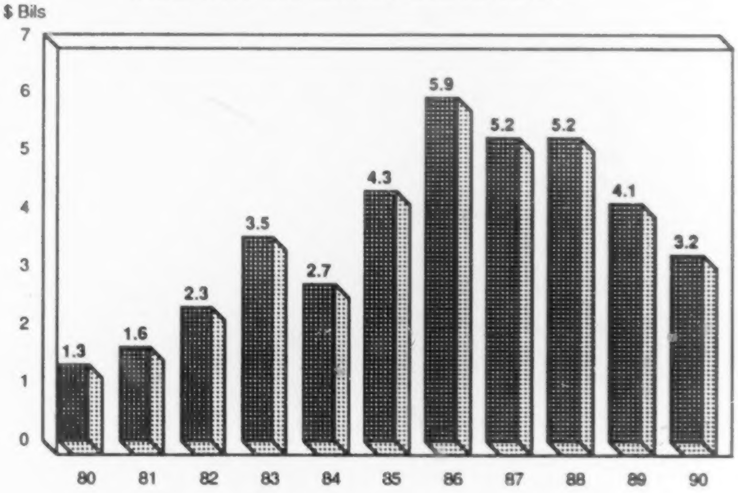
INSTITUTIONAL TRADING OF CORPORATE BONDS
(Average Daily Market Value Traded)



Source: SIA's "Investor Activity Report" *Jan-Feb

In the capital markets arena, the 1990s definitely got off on the wrong foot. Industry underwriting revenue fell over 20% last year to the lowest level since 1984, also a tough year. This is merely half of 1986's record showing. The dollar volume of new corporate issues actually set a new high, $314 billion, but this masks the business mix shift which occurred over the past few years.

INDUSTRY UNDERWRITING REVENUE



Source: Securities Industry DataBank

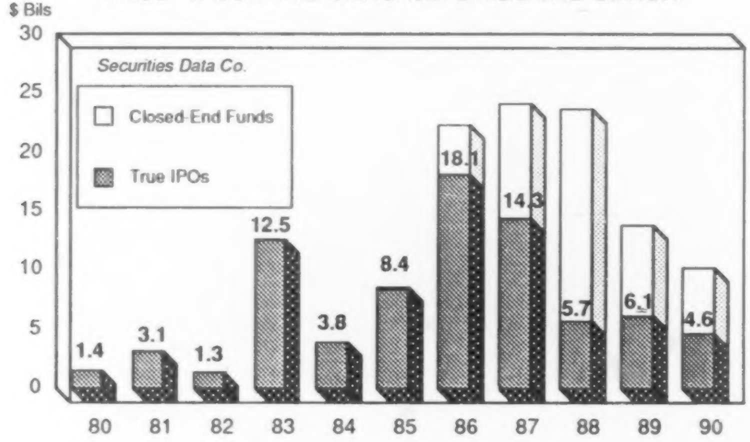
Of the total underwritten last year, $179 billion, or 57%, was in asset-backed debt, the lowest margin business for syndicate departments. Also, Wall Street no longer has a lock on this business. Since the Federal Reserve granted expanded underwriting powers to its charges' "Section 20" affiliates[4], six banks joined 19 securities firms as lead managers of all asset-backed bonds underwritten last year. Furthermore, an additional 34% ($107 billion) of the total came from underwritings of other straight corporate debt, also with very thin underwriting spreads.

There was no good news from the underwritten tax-exempt market either. Municipal bond underwritings have been flat since the Tax Reform Act of 1986 and last year was no exception. With state and local governments across the nation scrambling to close budget gaps due to lower than anticipated tax revenues, exacerbated by further cuts in federal revenue sharing, the immediate prospects look dim despite the pent-up demand for infrastructure rebuilding.

Little IPO Action

Making matters worse, the two "gravy" underwritten products, equities and junk bonds, were practically non-existent last year. Equity underwritings began the year slow and, post-Kuwait, they totally disappeared. The annual total, $24 billion, was the lowest amount of publicly underwritten equity since 1984.

"TRUE" IPOs HAVE CRASHED SINCE THE CRASH



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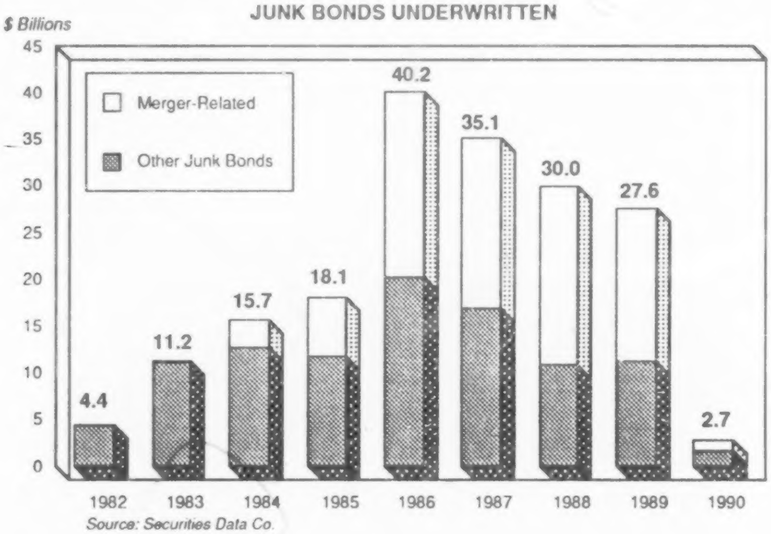
[4] The Glass-Steagall Act of 1933 generally prohibits banks which are members of the Federal Reserve System from underwriting and dealing in securities other than U.S. Government and general obligation bonds of states and municipalities (bank-eligible securities). Section 20 of the Act permits banks to be affiliated with firms that are not *principally engaged* in securities activities which are forbidden to the bank itself. Beginning in 1987, the Federal Reserve Board began approving applications by banks to allow these "Section 20 subsidiaries" to underwrite and deal in bank-ineligible securities, including corporate and asset-backed bonds and most recently corporate equity, as long as these activities remained below certain pre-determined thresholds, i.e. not *principally engaged.*

For new companies trying to raise capital via initial public offerings (IPOs) of stock, 1990 was an unqualified disaster. Following two post-crash years of extremely little IPO action, only $4.6 billion in "true IPOs" made it to market last year, again the lowest since 1984. A dual-edged sword was at play. Lack of investor confidence made it nearly impossible to market IPOs while these equity-shy investors, particularly post-Kuwait, sent market levels crashing to multiples that even small companies starving for new capital were reluctant to sell at. The lack of IPOs, the most lucrative deals in terms of underwriting spreads because of the higher associated risks, has sorely hurt corporate syndicate revenues.

Fortunately, 1991's rising market signaled many of these companies, long warming the bench, to get back into the ball game. Although not too many have been able to go to bat as yet because of the delay time in the SEC's registration-to-effectiveness process, line-up at the plate is growing rapidly. Even many of the LBOs of the past are coming back to go public again. The predicted re-equitization of leveraged corporate America is showing signs of getting off the ground.



Source: Securities Data Co.

Likewise, the absence of junk bond underwritings, also carrying wider gross spreads, has contributed to the shrinkage in underwriting revenues. After peaking at $40 billion in 1986 during the height of merger-mania in the U.S., junk bond[5] underwritings tapered off annually until the Fall of 1989 when the market for junk crashed.[6] After Drexel's collapse the following Spring, the junk bond market dried up completely as seen in the preceding table.

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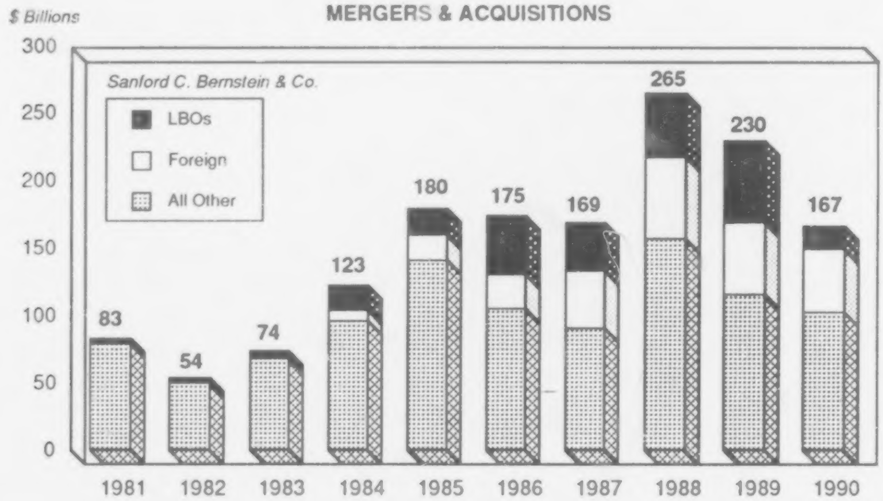
[5] Corporate bonds which are rated (or implicitly rated) below investment grade by either Moody's or Standard & Poor's. The vast majority are high-yield straight corporate bonds but also includes some convertible corporate bonds.

Mergers & Acquisitions

The paralysis in the junk bond market had ramifications far beyond just underwriting fees. Much of the merger & acquisition work, particularly LBOs, was made possible by a ready audience for the junk bonds issued to finance these deals. With this option closed off, M&A activity fell by 27% last year. Gone were the most lucrative fees from LBOs and other restructurings, the bridge loan income earned between the M&A fee and the eventual junk bond underwriting fee, as well as other incidental income such as eventual cash outs of gains from pieces of these deals bought by the advisors themselves.



According to Sanford C. Bernstein & Co., 1991 M&A activity should mirror last year's, at least in total volume of completed deals. While it is obviously still early to know the final outcome, Bernstein estimates that the higher equity prices in this year's market will deter LBO and other takeover activity while the higher dollar will dampen some foreign interest as well.

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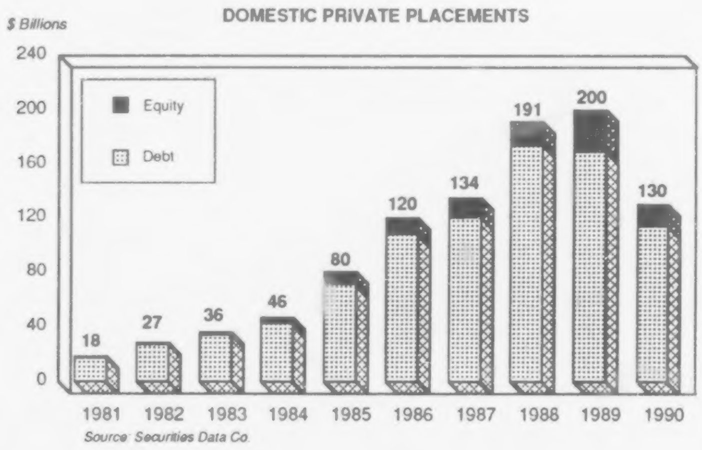
[6] In the Fall of 1989, several companies which had gone through large and well publicized leveraged buy-outs (LBOs) and other merger and acquisition (M&A) deals, mainly fueled from the issuance of junk bonds, could not meet the debt burdens taken on in their LBOs, and the market for their bonds crashed. The wake of these failures shied many investors away from the high-yield market and the resultant lack of demand for junk, the oversupply of junk, and the spreading defaults of junk, basically shut down this market. Also, the Resolution Trust Corp.'s liquidations of the portfolios of failed S&Ls intensified the selling pressure on junk bonds. All of this helped lead to the failure of the top junk bond securities firm, Drexel Burnham Lambert, in early 1990, which in itself shook an already battered junk bond market.

M&A fee income is included in the FOCUS line "other revenue related to the securities business." This revenue line fell by $3 billion or 15% last year. Not all of the drop, of course, was M&A related. Another revenue source included in this line, private placements, also witnessed a contraction by over one-third last year.

Private Placements

After a decade of spectacular growth, not even stunted by the crash of 1987, the volume of privately placed securities fell by 35% last year As mentioned in the last issue of *Trends*, the three segments previously fueling the post-crash growth – acquisition-related financings, junk bonds and ESOP financings – nearly evaporated in 1990, all down between 50% to 70%. Acquisition-related private placements suffered the same fate as the underwritten junk bond market while the recent, and short-lived, popularity of ESOP-related financings, including private placements, were curtailed by IRS rule tightening.

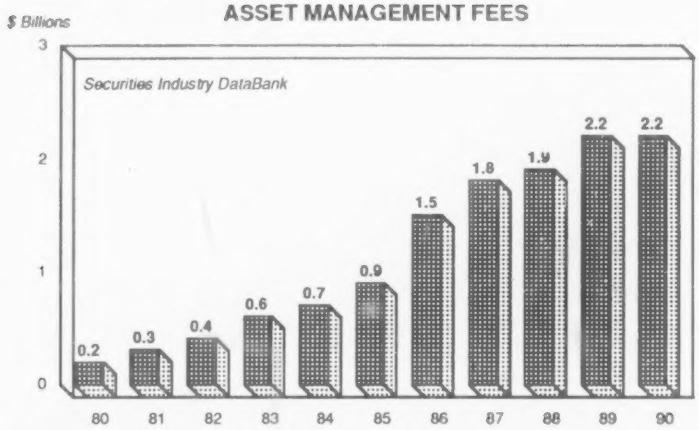


Source: Securities Data Co.

After reaching a peak of $32 billion one year ago, privately placed equity fell to half that level last year. Even the much heralded Rule 144A, albeit enacted just before 1990's market tanked, was not able to boost the level of private placements, with just under two dozen issuers, half of them foreign, taking advantage of the ruling.

Asset Gathering

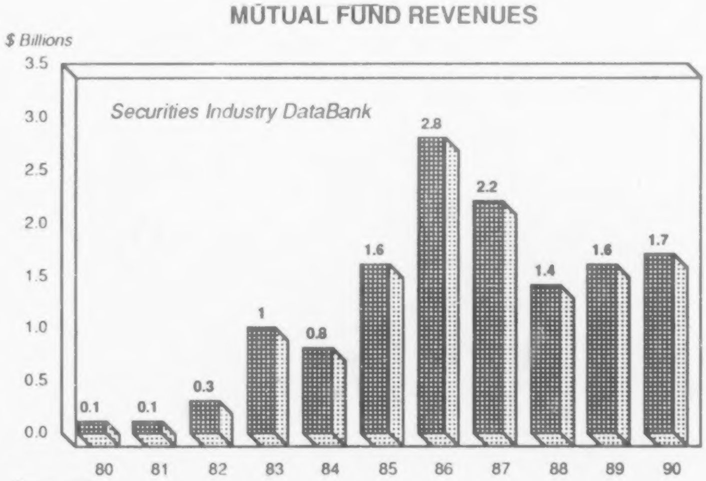
Despite the tough market in the latter half of 1990, one revenue growth area of the Eighties was able to achieve another record showing last year: fees from asset management and account supervision. The $2.2 billion earned from this source last year attained the record by the slimmest of margins – just $15 *million* more than that booked in 1989. Nevertheless, given the nearly across-the-board decreases in other revenue sources last year, the record was a considerable achievement.



The NFLs continue to dominate this business and are, in fact, gaining market share. Their emphasis the past several years on encouraging brokers (and compensating them more) ~~to bring~~ additional, if not all, customer assets in-house, "asset gathering," has helped smooth out some of the cyclicality of the transactional nature of the commission business. In the early Eighties, the NFLs had one-third of the industry's revenue from this source; from 1983 to 1988 they had about a 40% share. The past two years, the NFLs have garnered just over half of all these fees paid to broker-dealers. However, regional retail houses are now getting the asset gathering religion, and one of the newest products generating these fees, "wrap accounts," is now being offered more and more by Regionals.

Mutual Funds

Another area showing steady growth the past few years is the sale of mutual funds. Although revenues are still only three-fifths the peak they reached in 1986, they are still running at a post-crash high and trending up. Again, the NFLs also dominate this business area with approximately 70% of the industry revenues generated from this source. The majority of the balance is earned by Regional firms.



Reduced Repos

While the industry's repo book fell $26 billion, or 9%, in last year's first quarter, the industry financed itself with increased sales of repos throughout the year and Q4's level was up $17 billion over Q1. However, the industry's reverse repo book continued to shrink over the past 18 months, dropping $61 billion, or 24%, from 2Q89 to 4Q90. As mentioned in previous *Trends*, both drops were mainly from the Large Investment Banks which dominate this business and the cutback breaks the trend of a long-term build up of these businesses in the Eighties. Reverse repos grew from $18 billion of assets at the beginning of 1980 to a peak $259 billion at mid-year 1989 before the fall-off to $198 billion at 1990's close. Meanwhile, repos, as liabilities, grew from $21 billion in 1Q80 to a peak $278 billion by 1989's close; they finished at $269 billion in 4Q90.

Interest

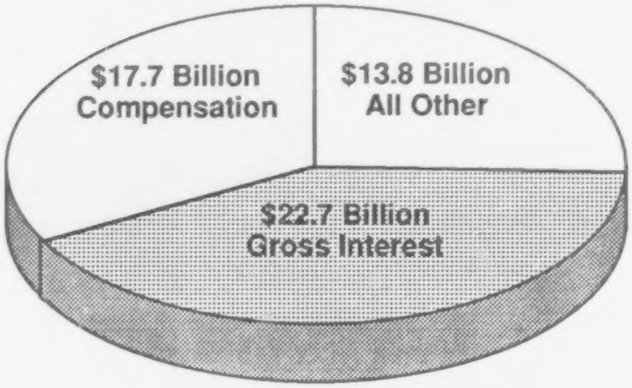
Margin interest steadily provided $3 billion+ in revenues annually the past five years. Nevertheless, last year's margin interest of $3.1 billion was $650 million, or 17%, below the previous year's record $3.7 billion booked. The NFLs, with about half the industry revenues from this source, showed a similar percentage drop as did the LIBs. Discounters and Regionals also showed tail offs in margin interest income but to a lesser degree. Although interest revenue from other sources is not available from FOCUS reporting, the previously mentioned drops in the repo business and the $3 billion, or 15%, drop in "other securities related" revenue (where other interest is booked), is indicative of similar drops in other interest income.

The flip side, interest expense, is available on a gross basis from FOCUS. After a 50% explosion in 1989 from $16 billion to $24 billion, gross interest expense became the industry's largest cost item, supplanting compensation costs' traditional #1 slot. After 1989's initial explosion, gross interest expense tempered somewhat last year, abating just under 6% – $1.4 billion. But since total revenue fell a higher 9% in 1990, gross interest expense's bite out of the total revenue pie rose to a record 42% last year, significantly higher than 1988's 32% bite and double the 21% cut as recently as 1983. The LIBs and NYCs still dominate this expense line, accounting for about 50% and 30%, respectively, of the total industry bill.

Net Interest Income

Of course, looking at just gross interest expense without gross interest revenue, i.e. net interest income (or expense), does not give a clear picture of cost control measures or profitability. On the one hand, most publicly held brokerages, where net interest income figures are available, show positive net interest income. On the other hand, as the industry became more capital intensive, interest expense exploded along with interest revenues and reduced the marginal returns earned from net interest income. Obviously, net interest income is a healthy source of profits, and often a large one, to the bottom line of most firms. Still, managing interest costs closely will be critical for cost controls.

1990 INDUSTRY EXPENSES



Securities Industry DataBank

Compensation Costs

As we've seen, the industry's largest non-interest expense is compensation. For the past two years, compensation was only one-third of all expenses, including gross interest. This compares with an average of 40% to 50% during the Eighties up until the crash. Part of the drop is directly attributable to the explosion in interest and its resultant larger piece of the total expense pie. With this escalating gross interest expense netted out, compensation is still a whopping 56% of net expenses. Still, cost control measures since the crash, particularly headcount related, is having an impact. Prior to 1989, compensation was 60% of net expenses throughout the 1980s.

On an aggregate basis, total compensation paid within the industry fell 6% last year. At $17.7 billion, 1990's payroll bill is down 13.8% from 1987's peak level of $20.6 billion. Still, employment has been trimmed by a higher 19.4% over this same time frame. Actually, immediately after the crash (1988), firms cut employment 8.8% while trimming compensation a close 8.3%. Last year, the cuts were almost as equal, a drop of 5.9% in compensation and 7.8% in employment; 1989 was the lag year when employment fell 4.6% but compensation stayed relatively flat, down only 0.5%.

While the figures are but aggregates across vastly different types and sizes of firms (as well as a shifting universe of firms), they do suggest that there has been some recent reductions in the higher compensated areas of the workforce relative to the back office personnel.

The NFLs made a lot of progress in this area last year. With the concentration of securities industry personnel employed at these firms, the bulk of the layoffs were also concentrated here. Of course, a large part of the reduction came from the previously mentioned consolidation in this group, i.e. Thomson McKinnon and Drexel were no longer in the 1990 data. NFLs' compensation tab fell by 8.4% last year on a workforce reduction of 10.3%, albeit a loss of 12,300 jobs.

Other Costs

As we've already seen, compensation costs fell 5.9% for the industry last year while gross interest expense fell a comparable 5.6%. All other costs, as a group, were reduced 7.0%. While this is a commendable, if not remarkable, progression in the industry's post-crash cost cutting program, profitability still suffered since total revenues plummeted a higher 9.2% in 1990. The only expense line not curtailed last year was "non-recurring charges." As discussed earlier, the heavy write-offs in Q1 drove the 1990 annual totals north by the order of 62%, or $150 million, over 1989's already lofty level.

Otherwise, all expenses were slashed last year. Occupancy and equipment costs fell the least, 2.2%, but are still just a hair below 1989's record cost level. Of course, there is somewhat of a long lag time for cost cutting measures undertaken in this area to flow to the P&L. Previous back-office moves across the Hudson by large New York headquartered firms will begin to show results in future P&Ls while further moves across state lines, some down the entire Eastern Seaboard, will have an impact later in the 1990s.

Total floor costs (commissions and clearance) were trimmed almost 7%. The savings came at the expense of specialists and $2 brokers, who have been under fire to reduce their charges. Floor costs paid to specialists and $2 brokers, about one-third of all floor costs, were shaved 30% last year, or by $226 million. The final tally, $518 million in floor costs paid to these firms, is the lowest total since 1985.

Obviously, with total floor costs down a much smaller 7%, something had to shoot up. Commissions and clearance paid to all other brokers rose $143 million, or 26%, most likely from the number of firms which dropped their self-clearing operations, becoming fully-disclosed correspondent firms.

Meanwhile, communications costs were cut a further 6% last year, to their lowest level since 1985. Other expenses which fell back to 1985 levels are EDP costs and promotional expenditures while losses from errors and bad debts were slashed by 30% to $300 million.

Conclusion

The foregoing expense cuts highlight the serious efforts which were made, with results now showing, in the areas of cost cutting. Part of the expense cuts, without question, are attributable to the shrinkage of the number of firms in the industry with fewer personnel on payroll. Still, the cuts were almost universal. Results of publicly held firms show these cuts at the individual firm level. Further, categories of firms showed an almost across-the-board cost reduction. NFLs and LIBs had expense cuts of 11% and 9%, respectively, last year. Regionals managed a 5% decline, Commission Introducing firms had a 6% cut while unclassified firms (other firms) showed cuts of 3%. Only the Discounters, which had a decent year, and the NYC-Based Regionals, which increased in number by one, showed cost increases, but both groups also generated higher revenue last year to offset these increases.

Still with one-third to one-half of NYSE member firms consistently posting red ink each quarter since the "crash," the over-supply, if still there, of the number of securities firms will dwindle further. As mentioned, the number of NYSE member firms last year fell to the lowest ever since records were kept, while the NASD's membership fell to its lowest level since 1984.

Certainly, those firms concentrating on the commission business have seen their prospects do a rapid about face this year. Commission revenue bottomed out at $2 billion in last year's final quarter, the same level as late 1982 to early 1984 and 30% below 1987's peak. Now, first quarter 1991 saw the best commission business in quite a while and the volume on the NYSE was up 26% from the previous quarter. February's volume alone, the second highest daily average, but on a rising market, translates into the *best* month ever in volume with many firms expected to post their best February ever for the bottom line.

Even the capital markets areas, though still slow to date, are receiving signals that some action may soon ensue. As mentioned, 1991's rising market signaled many IPO candidates, long warming the bench, to get back into the ball game. Even many of the LBOs of the past are coming back to go public again. Also, the predicted re-equitization of leveraged corporate America is showing signs of getting off the ground.

Although one quarter does not a trend make, hopefully better markets, less over-capacity in the securities industry, returning investor confidence, and a newly imbedded management philosophy of cost control, will translate into a healthier environment for brokerage firm profitability during the early 1990s.

George R. Monahan
Director of Industry Studies

UNDERWRITING

	FULL YEAR 1990	FULL YEAR 1989	% CHANGE 1990-1989
CORPORATE FINANCING (Gross New Issues - $ Mils)			
TOTAL	$314,168.8	$305,518.9	2.8%
Common Stock	$19,225.5	$22,932.7	-16.2%
# of Common Stock Issues	403	474	-15.0%
Preferred Stock	$4,621.9	$7,670.4	-39.7%
# of Preferred Stock Issues	87	108	-19.4%
Corporate Debt	$290,321.4	$274,915.8	5.6%
# of Corporate Debt Issues	1,339	1,371	-2.3%
MUNICIPAL FINANCING (Gross New Issues - $ Mils)			
Negotiated	$95,432.2	$92,325.9	3.4%
# of Issues	4,945	5,374	-8.0%
Competitive	$30,309.4	$29,932.9	1.3%
# of Issues	3,490	3,566	-2.1%

Source: Securities Data Co.

PRICES
(END OF MONTH)

	MAR. 1991	MAR. 1990	% CHG MAR. 1991-1990
DOW JONES INDUSTRIALS	2913.86	2707.21	7.6%
STANDARD & POOR'S 500	375.22	339.94	10.4%
NYSE COMPOSITE	205.30	186.84	9.9%
AMEX MARKET VALUE INDEX	359.20	361.75	-0.7%
VALUE LINE COMPOSITE	237.54	243.87	-2.6%
NASDAQ COMPOSITE	482.30	435.54	10.7%

YIELDS
(MONTHLY AVERAGES)

	MAR. 1991	MAR. 1990	BASIS POINT CHG 1991-1990
BOND BUYER INDEX (20 BOND)	7.10%	7.29%	(19)
CORPORATE BOND YIELDS (MOODY'S)			
Aaa CORPORATE	8.93	9.37	(44)
Baa CORPORATE	10.09	10.21	(12)
RATIO Aaa CORPS. TO Baa CORPS.	0.89	0.92	(3)

VOLUME

	FEB. 1991	YTD 1991	FEB. 1990	YTD 1990	% CHG YTD 1991-1990
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	224.9	195.1	155.9	164.2	18.8%
AMEX (MILS.)*	16.6	13.8	13.7	14.2	-3.1%
NASDAQ (MILS.)*	174.9	153.9	127.5	132.6	16.1%
REGIONAL EXCHANGE (MILS.)*	34.9	30.4	25.0	26.5	14.7%
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	$142,116	$257,880	$99,458	$233,980	10.2%
AMEX (MILS.)	2,801	4,832	2,978	6,769	-28.6%
NASDAQ (MILS.)	56,767	102,142	30,647	73,012	39.9%
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	49.3%	49.8%	51.1%	49.3%	----
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	12,107	23,915	9,764	22,194	7.8%
AMEX OPTIONS	N/A	N/A	2,798	6,553	N/A
COMMODITY	20,605	42,535	22,724	47,894	-11.2%

*MONTHLY AVERAGE
N/A - DATA NOT AVAILABLE

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Securities Industry

TRENDS

An Analysis of Emerging Trends in the Securities Industry
Produced by the SIA Research Department

Vol. XVII, No. 2

May 15, 1991

"COST CONTROL & MANAGING FOR PROFITABILITY"

Highlights of

SIA's 1991 Trends Conference

Selected Speaker Summaries:

James R. Jones
Chairman, American Stock Exchange
"Opening Address"

Michael Goldstein
Investment Strategist, Sanford C. Bernstein & Co.
"Managing for Profitability"

Michael A. Keane
Manager, Nolan, Norton & Co.
"Improving Performance in the 1990s"

Sally Hernandez-Pinero
Deputy Mayor for Finance, City of New York
"Luncheon Address"

Robert H. Whitby
Partner, Ernst & Young
"Strategic Approach to Cost Restructuring"

Donald L. Calvin
Chairman, International Business Enterprises, Inc.
"Concluding Address"

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"OPENING ADDRESS"

JAMES R. JONES
Chairman, American Stock Exchange

I'll open this Trends Conference by making three predictions on where the securities industry is heading in the 1990s. A company that wants to raise money around the world faces a wall of conflicting regulations. But now, the Europeans are bringing their accounting, listing and disclosure requirements into line. Prediction number 1: within five years, the U.S. will get on board, too. The major markets of the world will then have one set of rules that apply to major issues in major markets. A company seeking to raise capital in the U.S., Europe and Japan, will be able to do it all at once with documents that meet uniform standards. That's tremendously important because the market changes quickly and an opportunity delayed can be an opportunity lost. The result of uniform rules will be far smoother cross-national capital and ownership flows.

The Europeans have created an E-100 Index made up of 100 blue chip stocks in nine European countries. The Amex will trade warrants and options on the index, denominated in dollars. The MATIF (France) will trade futures denominated in ECUs. The European Options Exchange (Amsterdam) will trade options on the index, denominated in ECUs. The SOFFEX (Switzerland) will trade both options and futures, denominated in Swiss francs, and there are reports that both the Germans and the Swedes will participate.

We will have this pool of liquidity behind a common concept. Carry this concept one step further; prediction number 2. I can see a time when an investor looking to buy a stock can sit before a computer screen anywhere in the world and when the U.S. market is open, the investor can trade it in dollars; when Frankfurt is open, trade it in marks; when both are open, the investor can pick the best price in either market or any number of markets.

The system won't displace existing trading mechanisms; it will bring them together. The cooperative spirit exists to make that happen, especially in Europe. When will we see a 24-hour global market? I'll stay with my previous time frame, five years.

There is going to be a reduction in the number of independent markets now scattered around the U.S. There will either be mergers or other working agreements, or a number of markets will go out of business. The Germans followed this pattern in unifying Frankfurt's dominance over that nation's six smaller markets. Prediction number 3; again within the five-year period. The U.S. is likely to see not one but at least three prominent markets. The survivors will include auction markets and screen-based electronic markets, or hybrids. That's the end of the predictions. Now, I'll put them into context.

For decades, our industry was sheltered by regulations which kept banks in their place and foreigners off our exchanges. These rules restricted pension funds from investing overseas and limited competition among the markets. Overseas, the restrictions protecting exchanges and brokerage firms were even stronger.

However, that scenario is changing and change is a period of opportunity. But it won't be easy; there are obstacles.

Despite the ability of capital to flow across borders, protectionism isn't dead. When Europe '92 comes into being, it will have, at least initially, a protectionist undercurrent. Be that as it may, all of us are going to be in an international business in the sense that global events will affect our economic decisions as never before. This doesn't mean that you have to physically establish full-blown operations overseas, although some firms will take that step.

The American Stock Exchange looked at globalization and decided that neither we, nor any other market, had the resources to go charging overseas. Instead, we turned a potential weakness into a source of strength by forming alliances. We worked with Tokyo to obtain access to surveillance information from Japanese regulators. By January 1990, we were ready to launch trading in Nikkei warrants. Later in the year, the ties we developed also enabled us to launch options on an index of 210 Tokyo Stock Exchange stocks. During 1990, we followed the same approach in bringing warrants on the FT-SE 100 index traded in Britain. By November 1990, we were trading warrants on the CAC-40 index of 40 French blue chip stocks, while the Bourse traded warrants on the Amex's Major Market Index.

In each of these negotiations, the important factor was not simply the specific product we came away with. It was the *relationship* we developed. We want to get our listed companies onto foreign markets; to attract foreign investors to our new products, to open other business opportunities overseas. The key to this, in our belief, is relationships.

In this country, many business and government leaders realize that we need to create something like EC '92. We should be looking toward a North American free-trade zone which would represent a potential common market of 350 million people. There is a good deal of protectionist resistance to a U.S.-Mexico Free Trade Agreement, but we must get moving. Despite concerns about the Free-Trade Agreement with Canada, it is working so well that the two governments have decided to speed the introduction of new stages. Canada is our biggest trading partner. Mexico is our third largest and gaining, so we should broaden the Treaty to include Mexico.

Beyond this global picture, I think our industry must remember some fundamentals from the past. One is our responsibility to emerging and mid-sized companies. Without the new jobs, new opportunities and new thinking these companies provide, our society and economy will be diminished, and we will never be serious global competitors. The other traditional bedrock of our industry has been the individual investor. One of the exciting features of the market in recent months, was the reappearance of individual investors. Although they're constantly written out of our future, they refuse to vanish. Their participation is good for our markets and free-market economic system.

One final prediction. The U.S. has the most sophisticated, innovative securities people in the world. Therefore, buy a call, because I see a terrific decade ahead.

"MANAGING FOR PROFITABILITY"

MICHAEL GOLDSTEIN
Investment Strategist, Sanford C. Bernstein & Co.

If you compare surfing with Wall Street, the business wave of the early-to-mid-1980s was the "Big Kahuna." Similarly, October 1987's panic tidal wave of selling was the big "wipe out." Its aftermath left many battered brokerages on the rocks and others, totally submerged.

The securities industry is inherently unpredictable and volatile. If we look at the growth rate of net revenues (net of interest) over the decade 1980 to 1990, we see that it was 7.2% annually, on average. But, the standard deviation of this growth rate was more than twice as large, 17.6%, which, in statistics, is about as volatile as you can get. Similarly, although not as dramatic, the standard deviation of equity market returns about equalled the annual returns themselves, 14.0% and 14.7%, respectively.

But back to the "Big Kahuna" of 1979 to 1987. The volume growth over this period was 135% in bond turnover, 128% in stock turnover, and 191% in corporate underwritings. The growth in industry capacity is highlighted by a 96% growth in headcount combined with a 433% growth in industry capital.

Meanwhile, there was a countervailing force, in terms of industry profitability, at work during this period. Institutional equity commission rates fell 40% while debt underwriting spreads contracted a full 60%. In this aftermath came the "collapse," beginning in 1987. After 1987's first quarter peak, where the industry earned a record quarterly profit, to the end of last year (4/1/87-12/31/90), almost all industry parameters headed south. In volume terms, bond turnover fell 37%, stock turnover was down 24%, and underwritings fell 23%.

For capacity measures, only capital increased, 7%, but even here the trend was down after peaking at the end of 1989. Capacity, measured by headcount, fell 23%. The eroding margins in price which occurred throughout the 1980s continued during this contraction period. Institutional commission rates fell a further 10% and underwriting spreads a further 12%.

In just the past five years, the mix of business contributing to the industry's bottom line, and a shrinking bottom line at that, changed dramatically. Retail's contribution to profits altered dramatically. Retail's contribution fell from 21% of profits in 1986, prior to the crash, to 9% in 1988 and 12% last year. Traditional retail brokerage alone, where the vast majority of the industry's employment, physical plant and other efforts are concentrated, went from a mere 13% contributor to the bottom line in 1986, a good year, to a *consumer* of 10% of industry profits in 1988 and 1990. This basically nullified the profits from institutional sales and trading, itself under pressure. The saviour in retail was asset management, which climbed from 8% of total profits in 1986 to 22% in 1990, second only to proprietary trading as a bottom line contributor last year.

CONTRIBUTION BY LINE OF BUSINESS
(% of Net Income)

INSTITUTIONAL	1986	1988	1990
Sales & Trading	20	12	10
Underwriting	20	17	8
M&A/Advisory	20	31	20
Proprietary Trading	10	18	40
	70	79	78
RETAIL			
Brokerage	13	-10	-10
Asset Management	8	19	22
	21	9	12
OTHER	9	12	10
TOTAL	100	100	100
NET INCOME ($ Bils)	$3.8	$1.8	$1.0

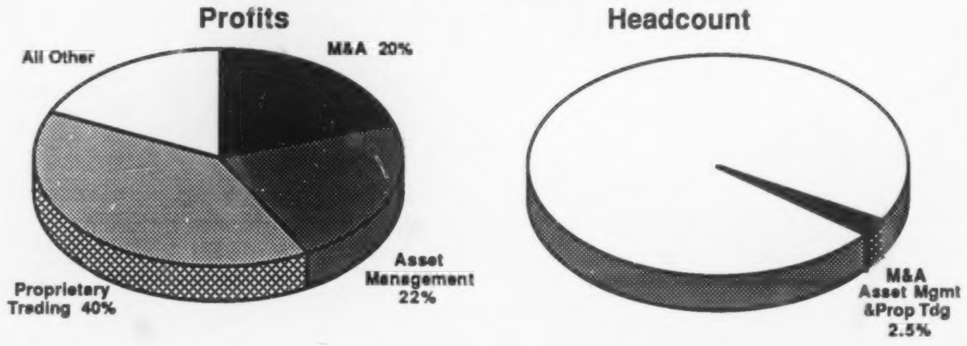
Most institutional businesses went through their own mid-life crises also. As mentioned, sales and trading was a 10% contributor to profits last year, half its 1986 level. We've seen earlier that institutional rates have fallen annually since deregulation in 1975.

The slashing of underwriting spreads, also shown earlier, combined with slow capital markets activity last year, led to a decline in these profits to only 8% of the total — again, a much smaller total to begin with, only one-quarter 1986's level. In actual dollars, last year's underwriting profits were only 10% of what they were five years ago.

M&A and other advisory fees have also been decreasing but are still around one-fifth of the industry's shrinking profit base. Only proprietary trading continues to generate between $300 to $400 million in annual profits, about $2 out of every $5 in profits last year, by far the biggest source.

This disequilibrium in the product mix contributing to profits is dwarfed by the disequilibrium in the workforce distribution earning these profits. As seen in the following chart, 82% of the profits in 1990 came from M&A, asset management and proprietary trading, while only 2.5% of the workforce is dedicated to these areas.

DISEQUILIBRIUM IN THE INDUSTRY — 1990



The payroll cost base (the largest non-interest expense of almost any firm), the infrastructure to support this workforce, etc. is 97.5% dedicated to areas only bringing in 18% of the profits! This support cost is important. While compensation per employee has grown 6% annually from 1980 to 1990, the growth rate for occupancy per employee has grown at more than twice that rate — 13% annually.

OCCUPANCY EXPENSE GROWTH HAS BEEN PROBLEMATIC

(Expense per Employee)

	1980	1990	Annual Growth
Compensation	$45,000	$82,000	6%
Occupancy Expense	$4,000	$14,000	13%

We saw earlier how institutional business profits and profit margins have been declining for years. The declining profits combined with the increasing costs of compensation and infrastructure can be devastating. These are areas where Wall Street can easily reduce costs.

The 500 largest institutional accounts (managing $1 billion or more) internally employ 8,170 portfolio managers, or about 16 per institution. Wall Street's institutional workforce, including support staff, numbers 50,000. That works out to a headcount of 100 each for these large 500 accounts or six times the number of portfolio managers being serviced. That's a lot of coverage for a not so profitable business line.

Firms have tried to respond by expanding their institutional business from a transactional business (trading) to bundled services such as asset management, trust services, clearance and custody, arbitrage and high net worth brokerage. They've moved more and more towards proprietary arbitrage, used institutional infrastructure to service wealthy individuals, and used their international expertise to penetrate emerging markets.

Other winning strategies will be the integration of the retail distribution network with asset management; further domestic and foreign risk taking through arbitrage and proprietary trading, and dominance in corporate financing relationships.

Areas for further cost control include: de-emphasizing further horizontal or vertical integration which rarely works; outsourcing; using ownership as a key element of compensation; monitoring support ratios and unit costs much more carefully; and watching for price competition, which is inevitable. Plan for it!

"IMPROVING PERFORMANCE IN THE 1990s"

MICHAEL A. KEANE
Manager, Nolan, Norton & Co.

Current approaches to performance measurement are becoming obsolete and may be interfering with our ability to move into the future. The financial services organization of the 1990s should emphasize factors such as quality, excellent service, and response time, as well as financial performance.

Today's securities firm is being squeezed by pressures to reduce costs and to do more with less. As usual, Operations, the back office, tends to take the first and most comprehensive hits. That tendency to slash causes a reduction in service levels and quality, but doesn't necessarily create improvements in the way we do business. Yet in spite of all the cuts in Operations, these are only about 15% of a firm's total costs. Obviously, for most firms, there is very little left to cut in Operations without adverse effects on service and support levels.

To manage costs and measure performance in the 1990s, we have to continue to look at financial measures. But, in the face of global competition, we will also have to measure other key factors which differentiate us from our competitors, factors which other industries have emphasized as a means of ensuring survival.

We need to look at how much time the firm needs to develop, sell, and distribute new products. We need to know how long it takes to develop, market, and support a new product, both in terms of personnel and technology. This is equally important for the innovator and the follower. If I launch a new product or service, I want to gauge how long it will take to do so fully, in order to understand my real advantage over the competition. If I am the competition, I want to know how long it will take to copy the product or service, to determine if I can be in that game or not. You must also know the knowledge of your people: chart it, develop it, and surround it with support technology to help move fast and take advantage of changing opportunities.

Those two factors together help constitute the firm's ability to innovate, learn, and change. Knowing how quickly we can change or upgrade skills and support systems tells a lot about our collective learning rate. In the information organizations of the 1990s, that may become the only sustainable competitive advantage. We need to look carefully at customer satisfaction. We need to be sure that our internal business processes, especially those that impact customers, are smooth, logical, up to date and not just an inheritance from the way we used to do things. In sum, we want a balanced business scorecard to account for the well-known factors we always monitored but also to chart our performance in significant areas of service and performance where previously we might have operated on word of mouth or wrong assumptions. How do we measure performance to the customer?

Time — how quickly and effectively do we satisfy our customers? Do we respond appropriately to their needs? If they want a product or service available at another firm, how rapidly can we create the same product? Once created, do we service it and support it and them well, or do we content ourselves with mediocre service?

Quality — how good and rapid is our decision making, either for customers who depend on our advice or for the risks we take as a firm? How quick do we get information to our customers, including internal customers, i.e. another department? How accurate is that information?

Service — take the pulse of the customer to find out how we are doing in terms of responsiveness, accuracy of our information, quickness to market, quality of services and products. You should measure your performance in this area against "world-class" competitors; even go outside the industry and take the best ideas from others to improve the customer's view of you.

Many organizations today are taking responsibility for portfolios of business processes, or portfolios of systems applications, in the same way they are responsible for securities portfolios. Identifying the 6 or 7 key processes, measuring our performance on them, and finding ways to improve them, are key to managing your business in the next decade.

Are we able to sustain innovation, change, and improvement? Indicators of market innovation can be revealing. Some firms are constantly innovating and generating revenue from new products. Others follow and fall behind. Do we really know our score? Do we know how long it takes to improve performance in a given area — how long to decrease errors, improve responsiveness, decrease response time? Do we know how good we are at gathering our intellectual assets, the best and the brightest, the collective expertise and experience of the best brains in the firm and making that expertise and experience available to other employees to get them up the learning curve more quickly and hasten their productivity?

What drives the scorecard? Executive management must emphasize the importance of all these perspectives to the health of the firm, and management must be hands on and "have skin in the game." Employees must understand and be committed to the strategy, to the customer, and to a never-ceasing search for better ways to work. They have to be encouraged to broaden their skill base through rotation and cross-training. We cannot afford to have employees spend 20 years in muni clearance; we need to develop them beyond that. The danger is that the 20 years becomes one year of experience repeated 19 times. You have to establish team-based accountability and you need to reward team-based performance that crosses over departmental barriers. The bedrock for this scorecard is the strategic use of information technology to supply the executive information systems that measure these factors.

This scorecard may be somewhat unconventional for our industry but I am confident of its value for gauging our continued success potential, our longevity, and our profitability. It talks about getting things right so that our ability to develop products and markets, support what we are selling, and keep our customers happy, is certain. I am confident that if we do those things right, the financials will work out right. Continue to measure the financials in your striving to manage costs and increase profitability, but insist on good measures of your customer's perspective, your organizational learning, and your processes, to balance out your scorecard.

"LUNCHEON ADDRESS"

SALLY HERNANDEZ-PINERO
Deputy Mayor for Finance, City of New York

Over the years, SIA and New York City have built an important and symbiotic relationship. We also often follow each other's leads and attitudes. The theme of this year's conference, "Cost Control and Managing for Profitability," proves once again that the industry and New York are thinking the same way.

Some analysts call this current economic climate a "cyclical downturn;" others call it a "market contraction." I call it tough. The recession began in and hit hardest upon our financial services and securities industries, the very firms that fueled much of New York's growth during the last decade. From 1980-87, more than 115,000 jobs were added in financial services, representing 40% of the City's private job growth. Since the crash, more than 50,000 jobs have been lost in the industry.

Our success will depend on how we meet immediate fiscal and managerial challenges, and how we balance that with investment and planning for tomorrow's climates. During an economic recession, the clock does not stop ticking — we must keep looking ahead. In New York, we are taking the difficult steps toward living within our means. But we're also working to ensure this City is the most competitive and attractive in the world, to stay the "Capital of Capital."

Throughout last year, we controlled our budget by balancing it and we shall do so this year and in the years to come. New York will spend no more than what it earns. Through these economic trials and transitions, the health of the securities industry remains a priority. A more profitable industry means more tax dollars for the City, and more jobs for our workers. I recently created a new economic development "think tank" — the Industry and Commerce Group — that allows us to further explore areas of specific concern to you. For example, as high tech and computer automation become the norm in financial information technology for the 1990s, there is no reason why New York cannot set the world standard for making trades faster and less expensive to process. This is why I personally have been so supportive and enthusiastic about the new Securities Industry Automation Corporation facility in the Metrotech Center in Brooklyn. SIAC is the ideal example of the kind of competitive planning and investment the City and the securities industry can do together. It is among the most advanced facilities in the world for information and communications.

Computerized trading technology is here to stay, and it is expanding your jobs from a regional and national view to an international horizon of securities transactions and money flows. You need to be in a center where this information can flow freely and reliably. The last thing you need is disruptions in your network. This is why our Department of Telecommunications and Energy has joined with industry leaders on the Mayor's Task Force on Network Reliability that was formed even before the disruptions on Wall Street last fall. The Task Force works on preventing such disruptions, and if something does occur, it will make sure an effective contingency plan is in place.

Advanced information technology naturally means increased financial innovation in the securities markets. It means finding new ways of trading capital, using different methods and offering different kinds of capital products. New York should be at the very core of this financial innovation and a core of bright ideas requires a corps of bright people. The Board of Education's Academy of Finance trains our young people for entry-level jobs, it builds this cadre of bright and talented workers and keeps our city on the leading edge of financial creativity.

Yet, innovation in the securities industry can be, and has been at times, threatened by burdensome and ineffective legislation at different levels of government. Last fall, the federal government toyed with the idea of a securities transaction excise tax. This tax was a dagger pointed directly at the securities industry and at New York. Mayor Dinkins and City Hall lobbied intensely, and successfully, with industry officials to persuade Congress and the Bush administration to abandon this dangerous proposal, which would have crippled our already fragile economy.

Mayor Dinkins appointed a committee on Global Competitiveness to analyze those factors that inhibit the international competitiveness of New York's banking, securities and insurance industries. And when New York City goes to market, we have two new strategies that help us prove that New York is the best investment around — outreach and diversification. Outreach to the securities and investment community with our message that the Big Apple offers unparalleled security as an investment. We don't do magic with our budgets, we adhere to quarterly budget balancing using GAAP. We meet with investors and rating agencies to show how we close budget gaps thoughtfully and carefully.

For diversity, we constantly look to develop new institutional and retail buyers both in New York City and outside. Expanding the market for New York bonds lowers the overall cost of the debt that we must raise to invest in the infrastructure that is the foundation of our future. We're also diversifying the credit structures to offer better products to New York investors. We are looking for new ways to enable entities, such as Health and Hospitals Corp., to issue debt. A variety of credit structures means a more efficient and targeted investment for the buyer.

And finally, we're diversifying our loan structures, with instruments that provide flexibility, such as variable rate bonds or zero-coupon bonds. Just recently, the City successfully sold its first-ever variable rate bonds. The bottom line to all of this is better cost management and creative management. We have learned much of this creativity from many of you in the securities industry.

Because managing for profitability in the 1990s will be remarkably different than it was in the 1980s, we're going to have to work hard to stay ahead of the competition, whether from Los Angeles or London. Our history of working together gives us an instant edge in this game of global markets. Our immediate challenge is to keep the edge and our longer-term challenge is to expand this edge. We have created new partnerships with the securities industry that will do just that.

"STRATEGIC APPROACH TO COST RESTRUCTURING"

ROBERT H. WHITBY
Partner, Ernst & Young

First, some of the securities industry's results last year. Revenues declined in 1990 for the first time since the 1970s. The declines were felt across most product lines including: commissions, underwriting, repos and reverse repos, mergers and acquisitions, and private placements. Expenses decreased last year but less than the proportionate revenue decrease. The industry showed a net loss of $162 million, pre-tax, the first annual loss since 1973. What are the implications? Here are a few:

- ❒ The entire industry — not just some firms or products — is having trouble.
- ❒ Volume declines and the disappearance of entire markets (e.g., junk bonds) have created *substantial, structural overcapacity* in the industry.
- ❒ As the number of firms has declined, total capital in the industry has increased. Achieving economies of scale requires more capital than ever before.
- ❒ Further economies of scale will require still more capital. New capital can only be attracted to the industry when opportunities for profitability are restored.
- ❒ The recent increase in volumes and pre-tax profits in the first quarter of 1991 provides firms with much needed capital to fight growing cost pressures. However, this cannot be the standard method of approaching cost pressures.
- ❒ Industry solutions will require:
    - ✎ Industry capacity reduction;
    - ✎ Recognition that there will be few global and few full service players;
    - ✎ Strategic re-focus into areas of competitive advantage, with withdrawal from "also-ran" activities and from "overextending;"
    - ✎ Strategic cost restructuring, firm by firm.

Within the context of these solutions, I will highlight the methods for achieving strategic cost restructuring. But this must be accomplished with a realization of the other problems and solutions the industry faces. There are three basic steps to cost restructuring, with the first steps being the most effective. These are:

Step I: Analyze & Restructure Business Portfolio
Step II: Cost Re-Engineer Selected Core Businesses
Step III: Block and Tackle — Basic Cost Reduction

The first step is one which is conducted by the CEO and senior management and where 40% to 50% of total savings can be achieved.

Step I: Analyze & Restructure Business Portfolio

- Review and classify all businesses;
- Separate core businesses from non-core;
- Develop a screening process employing basic economic hurdles and apply to all businesses (ROE, capital risk, profit, volatility, etc.).

For example, ABC Securities, Inc., has several sub-businesses. After evaluating these businesses, separating them into core and non-core, and screening each to see if they make certain basic economic hurdles, ABC segments these businesses into four categories: non-core that fail the hurdles, non-core that make the hurdles, core that fail, and core that make the hurdles. The following actions should then be taken.

Non-Core — Fails Hurdles:
- Liquidate.

Non-Core — Makes Hurdles:
- If possible to sell at a premium: *Divest*
  - — Realize capital gain
  - — Redeploy firm capital into core businesses.
- If not possible to sell at book value or better: *Retain*
  - — Protect earnings stream
  - — Avoid taking a capital hit.

Core — Fails Hurdles:
- Give management 60 days to develop a plan for passing hurdles;
- If plan is acceptable, support its immediate implementation;
- If plan is unacceptable,
  - — Re-define as a non-core business
  - — Downsize or liquidate.

Core — Makes Hurdles:
- Keep businesses and evaluate for cost reduction opportunities.

Step II: Cost Re-Engineer Selected Core Businesses

The objective of Step II is to fundamentally re-engineer a selected few core businesses to achieve a significant cost reduction of 40% to 50% in the corresponding cost structures. Such opportunities may present themselves in only 10% to 20% of your core businesses. Even so, you should expect to realize 30% to 40% of your firm's total cost savings opportunities from cost re-engineering these selected activities.

First, look at opportunities for reducing costs *significantly* in the remaining portfolio of core businesses. Consider possible synergies and economies of scale in your current portfolio of core businesses. Challenge the corporate framework — do not look only for savings of 10% to 20% across the board; look for radical, significant cost savings, consolidations, and entirely new ways to approach the business.

Review the total cost structure, both fixed and variable, of each core business and conceptualize methods for re-engineering this cost structure to *significantly* reduce total costs. Ideas may include: merging activities; introducing technology (e.g., image processing, telecommunications networking); outsourcing, or moving operations to a third world country to save on labor costs. Obviously, this last point might be a little radical for a securities firm (however, across the Hudson is not), but the idea is to really rethink the cost structure, to challenge the corporate framework. Only in this way can one find *significant*, 40% to 50%, cost savings opportunities.

Next, is the process. Elicit ideas from top management and remember to challenge them. Present the same challenges to independent consultants. Then, combine all re-engineering plans and conduct a management forum to choose the most viable plans and implement them. Devote your full energy to these chosen strategies where the possibilities for success are the highest. In this way, you can achieve *permanent* cost reduction that will yield *competitive* advantages.

Step III: Block and Tackle — Basic Cost Reduction

Unfortunately, this step is often the first, and sometimes the only one firms take. However, it is where you achieve the least cost savings of all three steps. It involves streamlining operations and eliminating waste. You should evaluate your activities to determine which add value to the process and ultimately, to the product. Techniques may include "activity based cost management," "process value analysis," "capacity management," and other efficiency management tools. Use of these techniques can provide management with: better understanding of the causes of an activity; analytical means with which to monitor process performance, and, ultimately, the necessary insight to *do it right the first time!*

When all else fails, you can mandate a universal reduction of 10% to 20% of activity in those areas that are deemed the least productive. But remember, 40% to 50% of cost reduction will be obtained in Step I, the business portfolio restructuring conducted by the CEO and senior management. An additional 30% to 40% can be found in Step II, process re-engineering conducted by middle management. Only 10% to 20% of total savings can be found in the block and tackling mode.

"CONCLUDING ADDRESS"

DONALD L. CALVIN
Chairman, International Business Enterprises, Inc.

A quick trip around the world for developments on the Conference theme — profitability.

London — The profits of Nomura for the first six months of its current fiscal year are greater than the combined profits of all U.K. firms for *full*-year 1989. Meanwhile, Nomura's current fiscal year is its worst in a decade while 1989 was the *best* year for U.K. firms since 1986.

Problems in London

1. Overcapacity - too many firms chasing too few customers.

2. Over-optimism; firms were convinced that London would become *the* world financial center. In a dose of reality, the "International Stock Exchange of the United Kingdom and the Republic of Ireland" is changing its name back to simply the "London Stock Exchange."

3. A lack of planning; firms believed it was possible to "muddle our way through to profitability."

4. Large problems of changing regulatory and business environments, i.e. a new "Financial Services Act," four self-regulatory organizations, the SIB, the DTI, etc.

5. The local U.K. retail business has mainly been dependent on government privatization (British Telecom, British Water, etc.), which is transient.

6. A key to growth and profits was to attract international business to London, especially in non-U.K. stocks. The success of efforts to attract trading in foreign stocks to London appears to have already peaked. Why? European exchanges are now more competitive. Amsterdam, Paris, Brussels, and Switzerland have all taken recent actions to attract and keep business in their home markets. Sweden has been the exception. This is because of the Swedish stock transfer tax and allowing investment outside Sweden.

Developments in Japan

The profitability of major firms in Japan has been down 60-90% this past year. Still, Nomura made nearly $3.4 billion for the fiscal year ended March, 1990. By contrast, in 1986, the best year ever in the U.S., total profits for *all* NYSE firms reached only $5.5 billion Even with a 60% decline in profitability, Nomura had $1.5 billion of profits for the year ended March 31, 1991. By contrast, NYSE member firms *lost* $162 million in 1990.

Japan has fixed commission rates and most business is retail. Securities commissions account for 41% of Nomura's worldwide revenues compared to 15% for Merrill, 2% for Salomon and about 16% for all U.S. firms in aggregate.
Some recent events in Japan:

1. From January to August 1990, the Tokyo Stock Exchange declined 40%.

2. Average daily volume on the TSE in 1990 was down 70% from 1989.

3. Volume hit a high of about 1.5 billion shares a day in 1989 followed by a low in January 1991 of 175 million; volume is now back up to one billion for some days in February.

4. A key market factor has been the rise in Japanese interest rates from a low of 3% to about 8% early last year.

5. The decline in the real estate market has dried up real estate lending, which had been used to finance stock purchases in the past .

6. Retail customer came back in the market in February 1990, right after a January decline, just in time for a 40% further decline in values. As a result, Japanese money moved into the Japanese bond market and out of the U.S. fixed income market *and* U.S. equities.

7. U.S. firms, on the other hand, had their best year in Tokyo in 1990. The reason, in one word, is "derivatives." Hedging with financial futures in Tokyo began in the Fall of 1988, followed by index options in 1989, and arbitrage between the cash market and the NIKKEI 225 futures traded on the Osaka Stock Exchange, etc. Some, maybe many, Japanese blame the U.S. firms and their program strategies and derivatives for causing the collapse of the Japanese stock market.

One big question in Japan — when will the Japanese retail customer return? Sound familiar? Japanese firms are calling for a return "Back to Basics," i.e. selling to the retail customer. Nomura has some 4,400 retail brokers plus some 2,900 saleswomen (selling to Japanese housewives) concentrated on this effort.

Finally, competition between Japanese banks and securities firms are bound to heat up as Article 65 Glass-Steagall type restrictions are changed. Large Japanese banks are getting into the securities business worldwide.

Developments in the U.S.

The good news is that stock market volume is back. Average daily volume in February/March was more than 1987's record 189 million shares per day on the NYSE; 1991 may be a record year in terms of stock market volume. The economy in the U.S. may improve while getting worse in Japan, Germany and Europe, generally. Regulation, *over*-regulation, in the U.S. is a major cost and competitive problem for U.S. firms and institutions trying to compete with non-U.S. firms.

Summing Up

What does all this mean for U.S. firms trying to operate profitably outside the U.S.? There are a lot of lessons here, but I'll mention only some of them. First, the business culture is different from country to country. Therefore, you *must* understand the business culture before 1) even considering opening an office, or 2) doing any business by telephone or personal visits, or 3) dealing with local firms overseas.

Second, if locals can't make money, foreigners can't either, especially if they try to compete with locals. This is a hard lesson learned by U.S. firms in London. Third, as U.S. firms have done in Tokyo, firms must use the expertise they have developed which the locals don't have. Therefore, doing business overseas is an area of specialization. You cannot expect to do business the same way in Germany as you do in the U.S., or in Japan or London, for that matter.

Finally, the days of the worldwide "financial supermarket," which was the talk of the early 1980s, are gone for all but a very small number of firms. Interestingly, large Swiss and Japanese banks seem to be still pursuing the worldwide financial supermarket strategy.

In sum, do business overseas (or with foreigners) only in those areas where you can reasonably expect to be profitable; you cannot expect to operate profitability overseas in areas where you can't do so locally.

Edited by:

George R. Monahan
Director of Industry Studies

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Securities Industry

TRENDS

An Analysis of Emerging Trends in the Securities Industry
Produced by the SIA Research Department

Vol. XVII, No. 3 June 12, 1991

THE NORTH AMERICAN SHAKEOUT: STRATEGIES FOR TOUGH TIMES[1]

The securities industry vs. market and economic cycles
Overcapacity and price competition
Cost control and profitability
Individual investor's role in the market

RECENT SECURITIES INDUSTRY & MARKET TRENDS

Profitability and business conditions
American finance and the excesses of the 1980s
Leveraging and the diminishing role of equities
U.S. taxation vs. savings and capital formation

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[1] This issue of *Trends* excerpts observations and commentary about the current and future state of the securities industry from presentations by SIA President, Edward I. O'Brien, and SIA Senior Vice President and Director of Research, Jeffrey M. Schaefer. Mr. O'Brien's presentation was before a May 30 conference, entitled "Financial Institutions: The Shakeout," sponsored by the *Financial Post*, Toronto, Canada; and Mr. Schaefer's presentation was before the May 23 Eastern Region Meeting of the National Association of Securities Dealers. Contributions and editing by George R. Monahan, SIA Director of Industry Studies. SIA welcomes contributions to *Trends* from all sources, from member firms as well as others, relating to the securities industry and capital markets. Please send submissions to the attention of Jeff Schaefer or George Monahan, SIA Research Department.

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THE NORTH AMERICAN SHAKEOUT: STRATEGIES FOR TOUGH TIMES

The securities markets, and particularly the securities industry, are looking healthier today than we have seen in a long, long time. Although the equity and bond markets are doing fabulous right now and the profitability picture in our industry has changed dramatically, for the better, over the past few months, the securities industry's three-year recession and last year's record loss are still quite fresh in mind.

First, a little background of that "shakeout period" we've just come through. The U.S. securities industry had a $162 million pre-tax loss last year, the first loss since 1973's $72 million in red ink. In fact, NYSE member firms reported aggregate losses in four of the past five quarters ended last year.

The industry's equity base last year fell to its lowest level since 1986. Total capital fell to $35.8 billion, the lowest level since the 1987 crash. Commissions, a mainstay of the business for many firms, fell each quarter last year to a nadir not seen in many years. Finishing at $2 billion in the fourth quarter, quarterly commission levels were the same as late 1982 to early 1984. For full year 1990, total commissions of $8.9 billion were down 13% from 1989, and a sharp 30% below 1987's peak.

Securities industry employment contracted 20% since the crash, from 262,000 to 210,000; this is the lowest industry workforce since 1984. I could go on and on with sobering statistics on the industry's recession, but more important is "what have we learned from this experience?"

First and foremost, the securities industry has always been, and will always be to some degree, a captive of market events, and ultimately, macro-economic events, which cycle their way through our economies and over which the industry has no control. If you're a discount broker, or a retail firm, relying on commissions from individuals for 50% or more of your revenues and profits, you are likely to suffer when volume is down, when retail investors are not willing to make new investments. When real interest rates soar, investors will be prone to shift out of equities into fixed income securities. When the economy is in recession and unemployment is high, it curtails consumer spending and investment. When corporate earnings are down, the markets are down and volume is low, it's hard to show stellar results.

There are ways to hedge that; to diversify so that your revenues are not contingent on any one sector. But, the economy and the markets are intertwined and they will have good periods and they will have down periods, and if you are in the securities business there is no way to totally escape this cyclicality. This is as basic a conclusion as you will ever reach about this industry.

One thing our industry learned during this most recent tough period is that you have to watch your costs. At many firms, expenses did really get out of control in the 1980s. It is necessary to watch the bottom line in all businesses. As the headlines of the early-to-mid 1980s splashed stories of mountains of cash being made on Wall Street, and revenues were pouring in in record amounts back then, not only the public but in too many cases securities firm management itself became enraptured with the myth of endless profitability. MBAs were scooped up from every graduating class from every

B-school at ever escalating salaries. Clerical and administrative support staff were hired in numbers two-to-one for every producer added. Systems personnel, new and expensive technology, new headquarters buildings, new branch offices were all added on feverishly to grab a piece of the growing pie.

Industry Overbuilt in the 1980s

The sheer size and magnitude of the growth of the 1980s blinded many to a growing profitability problem in its midst, as well as to the often transitory nature of our revenues. Employment almost doubled in the 1980s, but compensation costs tripled. Revenues increased over three-fold, but expenses increased over four-fold. Meanwhile, profits, even at their peak, only doubled from the decade's start, and then crashed into the negative zone. Profitability measures, such as ROE, profit margins, etc., all peaked in 1980 and then declined during the "growth" period of the 1980s.

The industry overbuilt and there was overcapacity. Price competition was fierce and margins thinned or turned negative. Not dissimilar to London's *Big Bang*, many, if not most, firms continued to expand in the midst of these warning signs, layering on more costs in an effort to follow the bull.

Crash Brought Painful, But Necessary, Controls

Then came the 1987 crash. The growth ended and the over-extended cost base and shrinking profitability could no longer be masked by more and more revenues. What did the industry do? We cut and slashed. And the cuts were as feverish as the growth had been and as dramatic as the crash had been.

Most of these cuts were painful. Since the crash, one out of five securities industry jobs has been lost — over 50,000 of our former colleagues and friends are no longer in the industry. Entire lines of business which were revenue generators but profit losers have been eliminated. Salomon Brothers, until its exit the number one U.S. underwriter of municipal bonds, dropped out of this business just prior to the crash. Many securities firms and banks have since done likewise and most municipal departments are now dramatically smaller, streamlined or merged into other capital markets departments.

Prudential Securities has abandoned its efforts to be a major capital markets player. Many firms have dropped their self-clearing businesses, becoming correspondent firms, basically outsourcing this infrastructure cost base. Outsourcing has been used for other areas: research, systems, technology, mutual funds, etc. Many firms have merged to consolidate back office costs, to find some higher economies of scale. Some firms, faced with overcapacity and cost problems, simply closed their doors.

The point to be made here is that, as losses mounted, the attack on costs was necessarily dual in approach. The easier cost cutting was in the obvious areas: personnel, both clerical and professional; travel and entertainment; advertising; outside consulting fees; technology expense; closing of some offices; freezing of compensation; reduction of bonuses, and cutbacks in hiring.

The more difficult area involves cost-cutting as it relates to long range business plans. Here a firm, in cutting expenses, finds itself impacting several parts of the business when it cuts expenses in another area. Or a firm is faced with the reality that its deeply held business plans must be curtailed or in some cases abandoned.

These cuts, and other areas of cost controls enacted since the crash, will, when completed, position our industry to meet the challenges of the 1990s from a more realistic cost base. Hopefully, the lessons learned during these three years will be constantly refreshed in management's mind, built upon and embellished, not simply forgotten as the revenue line on the chart spikes up again as it is now doing.

Planning for the Future

Overcapacity and price competition are still with us today, even as the markets rebound. The current state of price competition in the industry calls for further cuts in costs relating to institutional equities, in underwriting and even in the newest business line darling, asset management. We have to plan for lower prices in these areas, whether they continue to generate more revenue or not.

We have to look at how we deploy our assets and our people. Studies have shown that in the past five years, the mix of business contributing to the industry's bottom line, and a shrinking bottom line at that, changed dramatically. Retail's contribution to profits altered dramatically. Total retail's contribution fell from about 20% of profits in 1986, prior to the crash, to about 10% the last three years. Traditional retail brokerage alone, where the vast majority of the industry's employment, physical plant and other efforts are concentrated, went from a mere 13% contribution to the bottom line in 1986, a good year, to a *consumer* of 10% of industry profits since the crash. If not for asset management, which climbed from less than 10% of total profits in 1986 to over 20% last year, total retail would have continued to show bottom line losses for the industry. Meanwhile, more than half of all profits industry-wide have been from M&A and proprietary trading.

This disequilibrium in the profit mix is dwarfed by the disequilibrium in the distribution of the workforce earning these profits. Less than 2% of our workforce is bringing in over half the profits which means there has to be some basic rethinking of our payroll cost base, our largest expense other than interest, and the infrastructure to support this workforce.

Studies have also shown that the securities industry employs six times as many professionals to handle institutional accounts than the institutions themselves employ to manage their huge portfolios. If there is one reason why institutional sales is a break-even, or in some cases, a loss business, this could be it.

We've heard a lot about globalization over the past decade and how important it is to get on this bandwagon for our future profitability. But we also saw what *Big Bang* did to profitability. There's overcapacity in international business and there is only so much room for so many major participants. Others have succeeded in capturing international business, or in capturing domestic business overseas, through alliances and joint ventures, a means of keeping investment low but broadening your horizons. These have been accomplished both by securities firms and various exchanges. Yet, the movement is still towards more internationalization and the expansion of free trade across more borders in the future. Again, plan for it.

I've mentioned that compensation is the industry's largest non-interest expense. Gross interest expense has gone from 20% of revenues in 1980 to 42% last year. Of course, this is weighted by the large investment banks and the industry is still earning net interest income. Nevertheless, with gross interest revenues and expenses both approaching half of our total revenue base, the industry's vulnerability to shifting machinations of macro-economic events affecting interest rates is increasing.

Ironically, this shift toward more interest dependence was a byproduct of a shift towards capital intensive businesses to diversify away from the agency commission business, itself cyclical. Therefore, I want to emphasize that whatever long range plans we, as securities firms management, must develop to build our businesses' profitability, we must do so in the knowledge that there are broad events beyond our control, something not easy for a CEO to acknowledge, and for which we must develop an alternate business plan. Under any scenario, it is absolutely required that there be tight control and allocation of costs relating to profitability.

So much for the past. Under what circumstances can the securities industry continue to grow and, as it must, prosper? Unless the industry is prosperous, it will be incapable of raising the capital needed, domestically and internationally, for corporations, governments and for the needs of our fellow citizens. It will also be hard pressed to advise clients, individual and institutional, on their investment needs for the present and for tomorrow.

Individuals Still Investors

The securities industry, in the past three years, has faced the challenge of attempting to be profitable by massive restructuring, by cost cutting, by changing priorities to meet client needs, by regularizing compensation in many instances. It has, at the same time, continued to train its personnel and supervise their activities without reducing, in any meaningful way, the resources devoted to customer protection and supervision of its employees.

There is clear evidence that investors have not abandoned investing. Our clients are more sophisticated and better educated and more demanding. And we can take some credit for that because of our research and client education programs. And the media can take some credit for it because of their expanded economic coverage.

Individual investors have not abandoned the management of their financial assets. They are interest rate and risk sensitive and this is reflected in their affinity for money market funds and by their shift to conservative investing practices when appropriate. CDs, money market and other mutual funds as well as a variety of fixed income investments have grown in popularity as interest rates declined. And in the first quarter of 1991, there is ample evidence of renewed interest in equities. This mixing of investment priorities reflects the changing needs of the increasingly sophisticated investor. This trend will greatly expand in the coming years.

Educated investors see value in long term investing, in prudent allocation of their financial assets and they are sought after by brokers who are well trained and equipped with the financial vehicles to serve these investors. Brokers are as eager as clients to build relationships, to plan for the future on a longer term basis and to meet the specialized requirements of their clients.

Despite the trend toward mutual funds and managed accounts for a fee, trends which will continue, there is a not yet fully recognized, equally important growth in investing in specific securities by individuals who retain the power of decision over their own investments.

Government Policies Have to be Examined

There is one area of concern, however, and it involves government economics and tax policies, but above all, government's way of looking at things. Within the past few years, while tax rates on ordinary income have surely gone down, investment incentives have withered away. Capital gain tax incentives no longer exist. The use of IRAs was severely curtailed in 1986. The U.S. remains the only one of eleven industrial countries to do nothing about alleviating the tax burden on dividend income. And the tax bias in favor of debt and against equity is so unrelenting that equities have fallen from 55% of securities outstanding in 1970 to 35% in 1990.

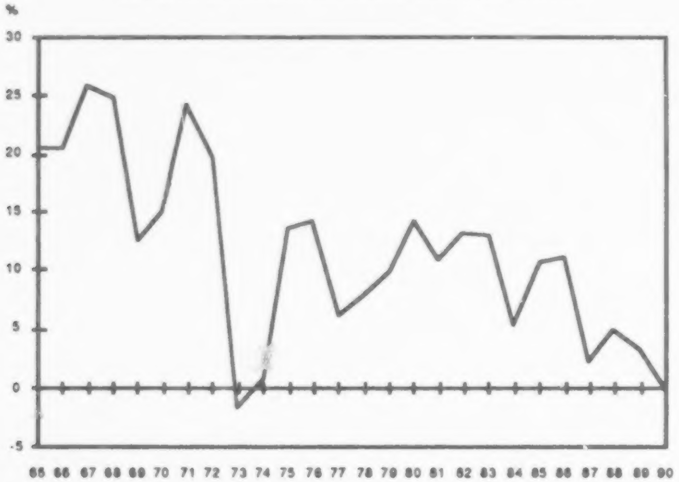
Our elected representatives must reverse the process and overcome their fear of profit and incentive for profit. The U.S., unquestionably the standard of the world for economic freedom, must return to its economic heritage and embrace incentives with enthusiasm and with faith in the future. If a meaningful sea change is perceived on this subject, then the future of the securities industry will be very bright indeed.

Edward I. O'Brien
President
Securities Industry Association

RECENT INDUSTRY AND MARKET TRENDS

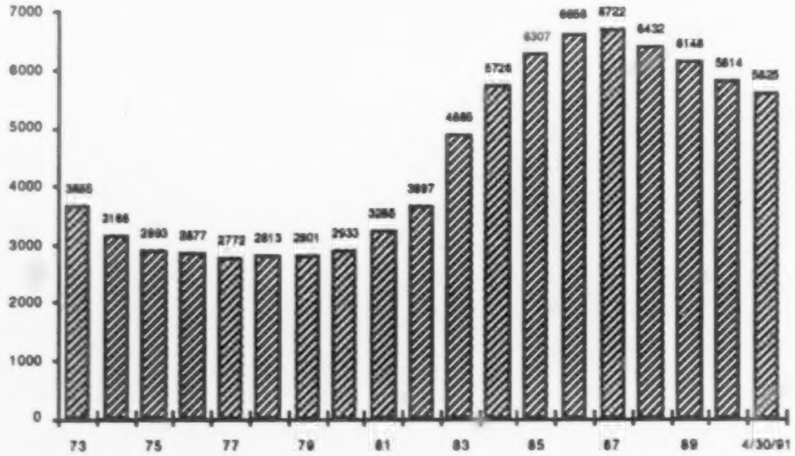
Although the profitability picture in our industry has changed dramatically for the better this year, the industry's three-year plus recession and last year's record loss are still fresh in our minds. Indeed, widely used trends measuring industry profitability have been in a downward slide for many years as shown below.

SECURITIES INDUSTRY PRE-TAX PROFIT MARGIN

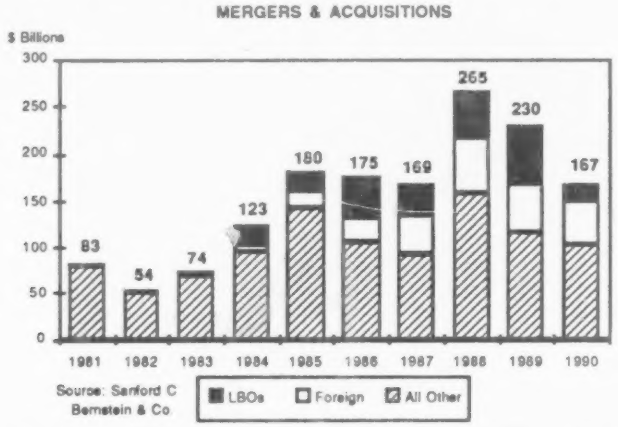


The industry incurred a record loss last year; weathered a string of four quarterly losses out of the five reporting quarters ended last year; survived shrinking equity and total capital bases; endured declining commissions to late 1982/early 1984 levels, and mounted a 20% contraction in its workforce to downsize the cost base. Indeed, since year-end 1987, 1,100 NASD member firms, or 16% of the industry, have disappeared in mergers or closings bringing us under 1984's total.

NASD MEMBER FIRMS

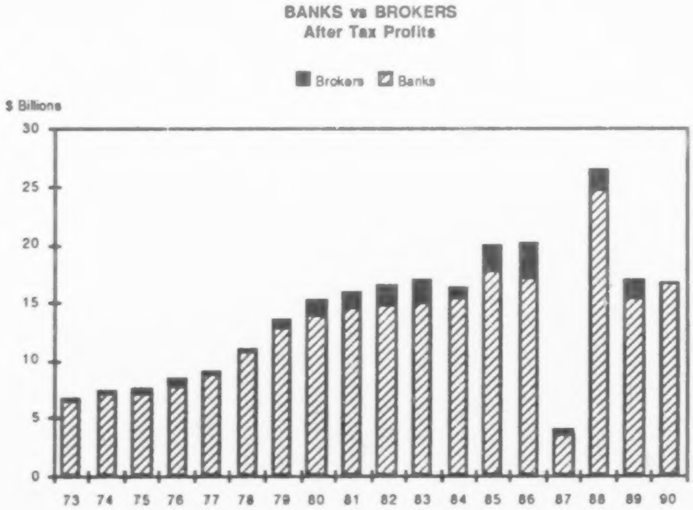


In the 1980s, American finance and U.S. capital markets were accused of being a gambling casino epitomized by greed where the way to win was by stacking the deck. Takeovers, junk bonds, bundling and unbundling of assets, etc., have come and gone, leaving behind successes and failures. The highly profitable M&A area is a prime example, which continues to dwindle from its heyday as seen below. More importantly, it seems that these developments have pitted Wall Street against Main Street, British industry against the City of London.



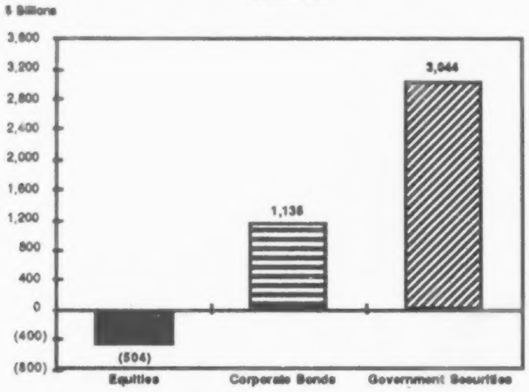
Source: Sanford C Bernstein & Co.

Many individuals feel finance should be the slave of industry, but became its master in recent years. Perhaps because of this, the market deviated from good sense and sound financial principles. Despite significant liberalization and freedom in our capital markets, many financial intermediaries are still under severe profit pressures. Commercial banks are weaker than at any time during the last 50 years. Indeed, Congress and the Administration are intent on debating the possible intermingling of commerce and banking as a means of alleviating U.S. banking's profitability problems. As shown below, the securities business is not the answer to the oversupply of banks in this country and their profitability problems.



In the 1980s, there were times when M&A activity induced arbitrary stock market valuations while management came under fire for too much devotion to asset shuffling and too little to investing in the future. On its face, the resultant corporate leveraging, from equity into debt, sounds like a deliberate move from health to sickness.

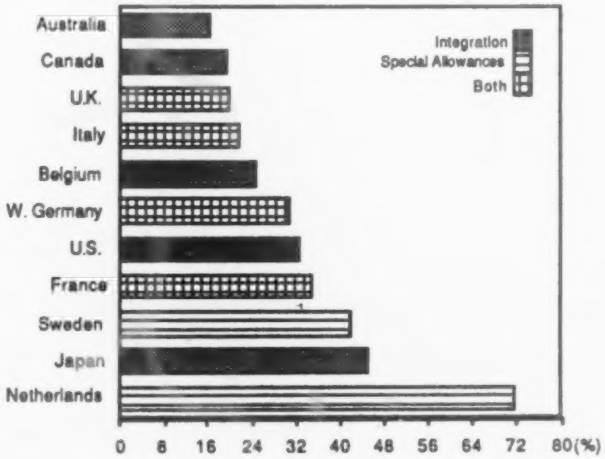
NET ISSUANCE
1980-1990



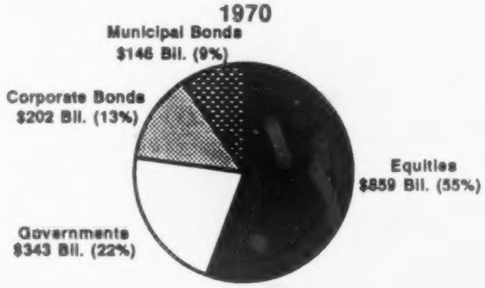
In the 1980s, buyers thought they could raise cash flows by breaking up companies, giving managers different incentives and controls, and by fully exploiting tax breaks favoring debt over equity. Naturally, this concept can get taken too far. Due to the double taxation of corporate income (dividends), the value of a firm may actually rise by taking on debt. Although there was a lowering of tax rates in 1986, the simultaneous removal of tax credits for investment and limiting depreciation write downs sustained this strong incentive to borrow. The U.S. remains the only one of eleven industrialized countries to do nothing about alleviating the tax burden on dividend income.

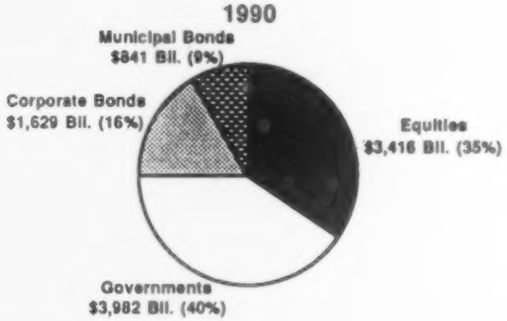
Maximum Marginal Or Effective Tax Rates
On Dividend Income

Industrialized Countries



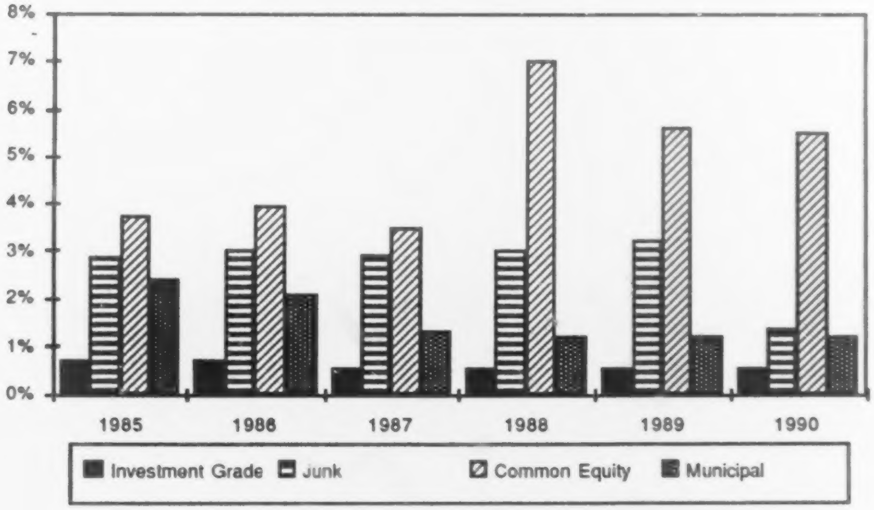
The movement away from equity to debt hurts the profitability of the securities industry. Sales spreads, in general, are higher for equities than for debt. Also, the instruments with the lowest underwriting spreads grew the fastest during the 1980s. In particular, government and corporate bonds have grown in relative importance to equities. Governments now comprise 40% of domestic securities outstanding compared to 22% in 1970. Meanwhile, equities have fallen from 55% of securities outstanding in 1970 to 35% in 1990.





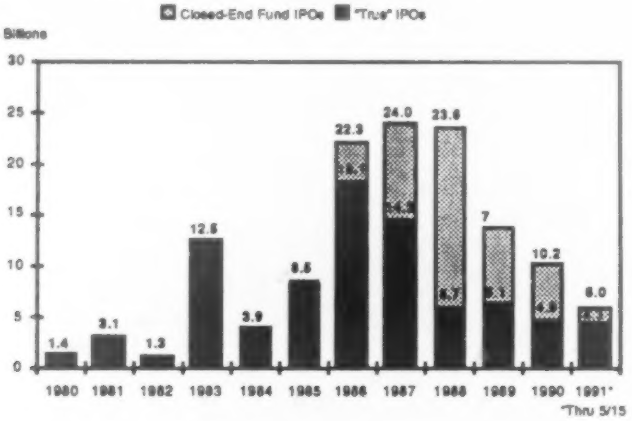
Adding insult to injury, spreads on all types of securities have trended down since the mid-1980s. Although spreads vary substantially even within the same class of securities, the general thrust has been downward, as seen below.

UNDERWRITING SPREADS
AS % OF PRINCIPAL



More damaging, the IPO market has been dormant until recently. Unless we can raise capital for new companies, job growth and international competitiveness will be stifled. Fortunately, in recent months a rash of IPOs have come to market successfully with more in the pipeline. Although this is encouraging, it should not be overdone lest we chase investors from this risky, but vital market for years to come.

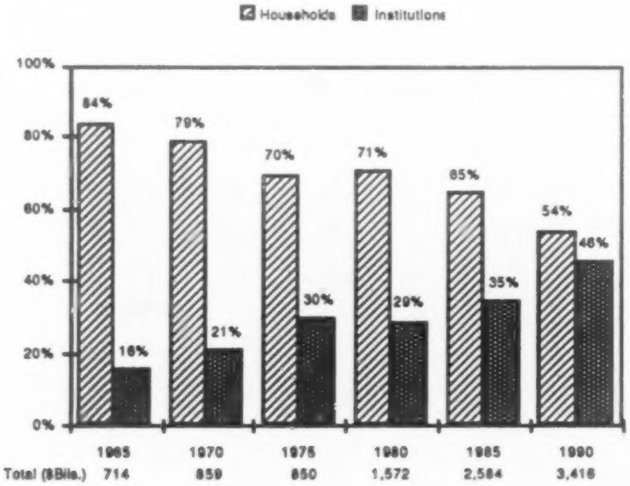
"TRUE" IPOs HAVE CRASHED SINCE THE CRASH



Holders of Equities

In 1950, Charles Wilson, President of General Motors, set up a pension fund for GM employees that was not limited to investing in GM securities. Within a year, 8,000 new plans were written. Our equity markets have not been the same since. In 1965, individual investors held 84% of companies' shares outstanding; by 1990, this percentage had plunged to 54%. Nevertheless, individual investors held $1.8 trillion of equity at year-end 1990 compared to only $600 billion in 1965. This $1.8 trillion excludes their stake in pension funds and mutual funds as well. However, institutions do dominate the trading of equities. This fact makes the markets move faster than ever before and seem more unforgiving of every corporate mistake.

HOLDINGS OF U.S. EQUITIES



Conclusion

The U.S. financial system has more freedom than ever before. That makes it an efficient and ruthless broadcaster of economic, political, and social frailties. The financial markets reflect rather than cause change. They reflect changes in taxation, cost of funds, changing bankruptcy rules, etc. The hostile takeover is the most prominent financial development because it exposes capitalism in the raw: high profits can be made or lost by risking huge sums of money for short periods of time while many individuals wait silently for an outcome affecting their jobs and lives. Surprisingly, the recent wave of mergers may have been more successful than those of the late 1960s and early 1970s. Although fewer of those mergers were hostile, there were more disasters because of the nonexistence of synergies across very different businesses.

Shareholders and managers have been different individuals since the 1930s. Back then, owners were rich individual investors with a direct stake in the outcome of the business they invested in; today they are pension funds or other financial intermediaries acting on behalf of many individuals. Such owners are investors in a vast portfolio of securities. Today they benefit from the market's general performance rather than from a particular company's. Recently, there are signs that the market is seeking to bridge the gap between ownership and control. However, this problem will likely remain given the dominance of institutions.

This is but one of many good reasons for targeting savings incentives for individuals, such as the IRA proposals by Senators Bentsen and Roth. A capital gains differential would not be a crazy idea either, or at least investors should be allowed to adjust their cost basis for inflation.

Finally, isn't it time America did something positive about the double taxation of corporate income without worrying about the revenue loss to the government? The markets simply reflect ill-advised government and corporate policies. Government and industry won't recover full health until we follow responsible fiscal policies at all government levels and lighten the real tax burden on profits and risk taking.

Jeffrey M. Schaefer
Senior Vice President and Director of Research

Securities Industry

TRENDS

An Analysis of Emerging Trends in the Securities Industry
Produced by the SIA Research Department
Vol. XVII, No. 4

August 16, 1991

INTERNATIONAL TRENDS & OTHER DEVELOPMENTS AFFECTING THE U.S. SECURITIES INDUSTRY [1]

Highlights

1. The U.S. securities industry outperformed U.S. manufacturing's ROE until 1987. Since the 1987 Crash, the story has been quite different with the securities industry considerably underperforming manufacturing until this year's first quarter.
2. Prior to the Crash, 15% to 25% of all NYSE member firms showed quarterly losses. Since then, roughly one-third to one-half of all firms showed quarterly losses until 1991 when rallying markets reduced the number to only 19%.
3. Well over a half a trillion dollars of U.S. equities was taken out of the market since 1984 through mergers, acquisitions, and other corporate restructurings. That this equity was replaced with debt, on top of escalating federal borrowing, remains a real concern to many. Fortunately, for the first time since 1984, there has been an increase in the supply of equity this year.
4. For much of the 1980s, U.S. interest in foreign securities was small, averaging $6.5 billion annually from 1980-88. Last year, net purchases reached a record $31 billion, following a then record $19 billion in 1989.
5. Gross cross-border capital flows increased substantially through the 1980s. In recent years, countries with large and persistent occurring account deficits attracted foreign capital (unlike earlier years), thus weakening pressures for policy adjustments. Nowhere was this more true than in the U.S., where foreign capital substituted for savings and internal investment.

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[1] This issue of *Trends* excerpts observations and commentary about the current and future state of the securities industry from a presentation by Jeffrey M. Schaefer, SIA Senior Vice President and Director of Research, before the July 17 Asian Securities Industry Institute, Manila, Philippines. SIA welcomes contributions to *Trends* from all sources, from member firms as well as others, relating to the securities industry and capital markets. Please send submissions to the attention of Jeff Schaefer or George Monahan, SIA Research Department.

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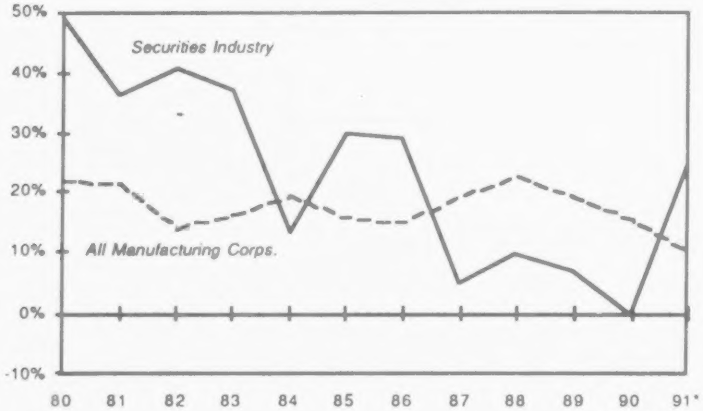
INTERNATIONAL TRENDS & OTHER DEVELOPMENTS AFFECTING THE U.S. SECURITIES INDUSTRY

For most of the 1980s, the U.S. securities industry outperformed U.S. manufacturing considerably, as seen below. Despite the downward trend in pre-tax ROE, the securities industry outperformed manufacturing until 1987. Since the 1987 Crash, the story has been quite different with the securities industry underperforming manufacturing in the U.S.

PRE-TAX RETURN ON EQUITY
Securities Industry vs. All Manufacturing Corporations



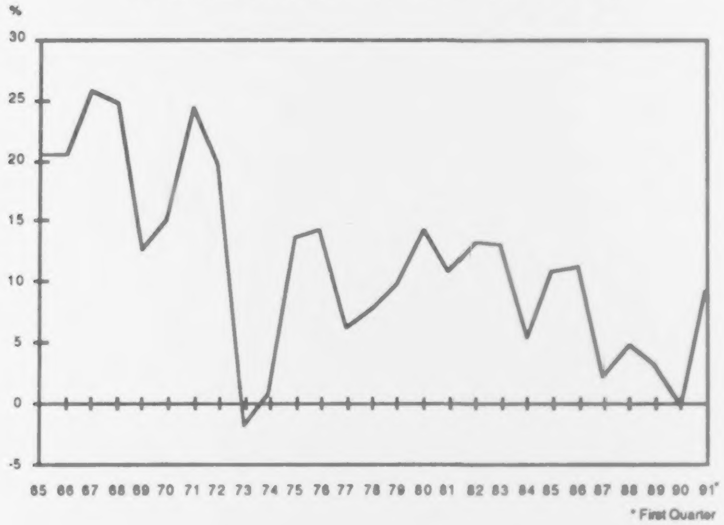
* First Quarter

Indeed, things deteriorated so badly in 1990 that the securities industry actually lost money. However, the strong first quarter of 1991 put us back to the pre-1987 trend, where the securities industry outperformed U.S. manufacturing. Furthermore, the 25% ROE earned during 1Q91 was only slightly less than the boom years of 1985-1986. Of course, it is still interesting that despite the strong performance during the first quarter which continued, to some extent, during 2Q91, the pre-tax ROE still was below that achieved during the early 1980s.

The U.S. securities industry's profit margin has generally trended downward since data became available in 1965. In 1967, pre-tax margins were 25%, or in other words, firms kept 25¢ of every $1 of revenues generated before the payment of taxes. This was the highest margin on record.

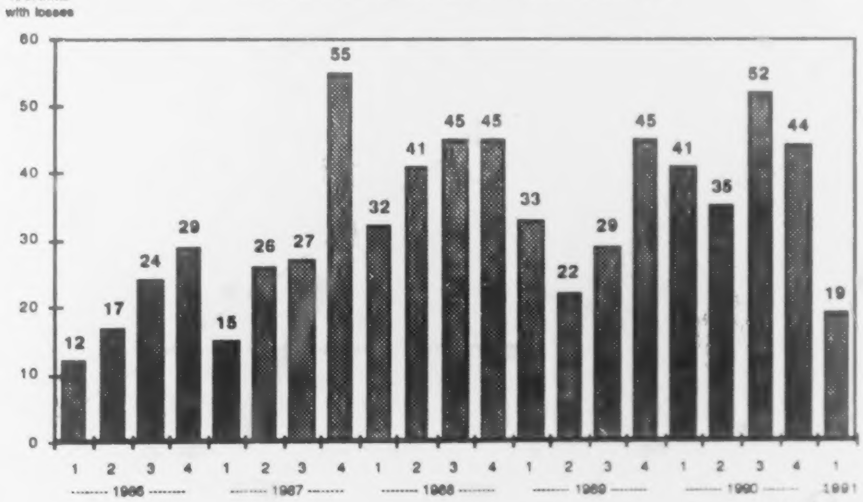
Although the securities industry grew rapidly in the 1980s and generated record revenue year after year, strong competition and the resultant narrowing of spreads earned in businesses led to declining margins, which were exacerbated by the Crash. The first quarter 1991's profit margin of 9.5% reversed this trend, at least temporarily.

SECURITIES INDUSTRY PRE-TAX PROFIT MARGIN



Prior to the worldwide stock market Crash of 1987, about 15% to 25% of all New York Stock Exchange member firms showed quarterly losses. During the Crash-impacted fourth quarter of 1987, over half of these firms lost money. Since then, roughly one-third to one-half of all firms showed quarterly losses until 1991 when rallying markets reduced the percentage of the NYSE's members with losses to only 19%.

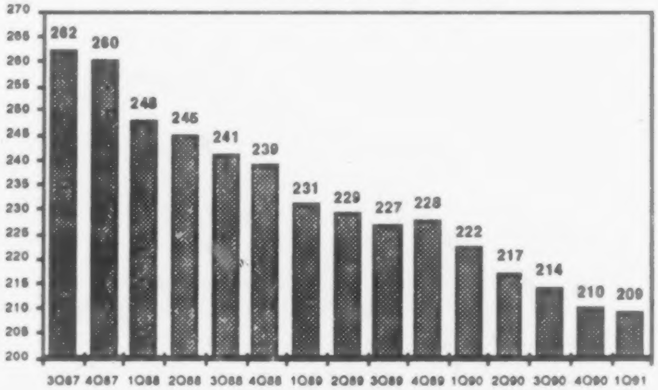
PERCENTAGE OF NYSE FIRMS UNPROFITABLE



From late 1987 through 1990, many securities firms closed or merged and most of the remaining firms were forced to downsize their business in order to survive. Employment fell to 209,000 by the first quarter of 1991, a loss of 53,000 jobs or 20% of the workforce in just over three years. Meanwhile, total capital dropped from a peak of $39.3 billion at year-end 1989 to $36.3 billion during 1Q91 due to a shrinkage in the number of players and charge-offs to capital from frequent quarterly losses.

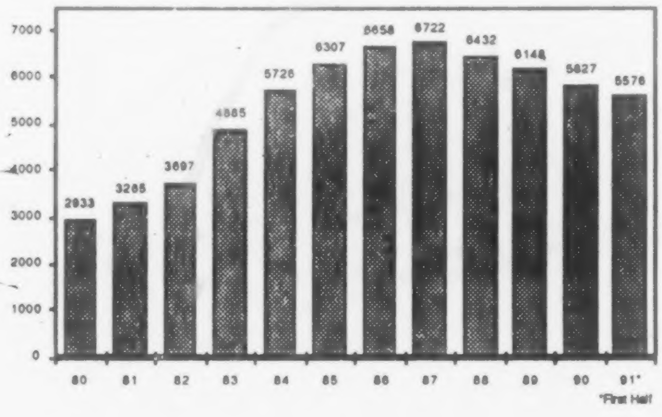
SHRINKING EMPLOYMENT SINCE THE CRASH

Securities Industry Employment in Thousands



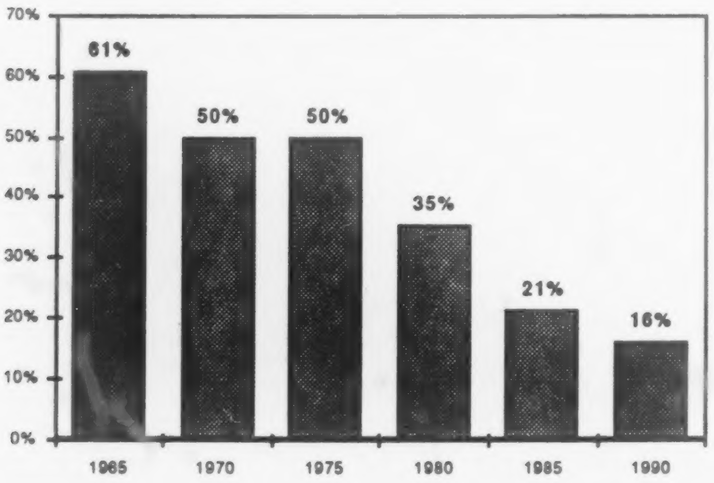
As mentioned, over the three years that one-third to one-half of all NYSE members incurred these quarterly losses, many firms closed or merged and most of the remaining firms were forced to dramatically downsize in order to remain in business. After peaking at 6,722 firms at year-end 1987, the number of NASD members fell to 5,576 by June 1991, a 17% contraction.

NASD MEMBER FIRMS



For several decades, the commission business has declined in relative importance to the U.S. securities industry. Over 60% of all revenues came from commissions in 1965. Half of all securities industry revenues still came from commissions in 1970 and 1975, the year fixed commission rates on U.S. stock exchanges were abolished.

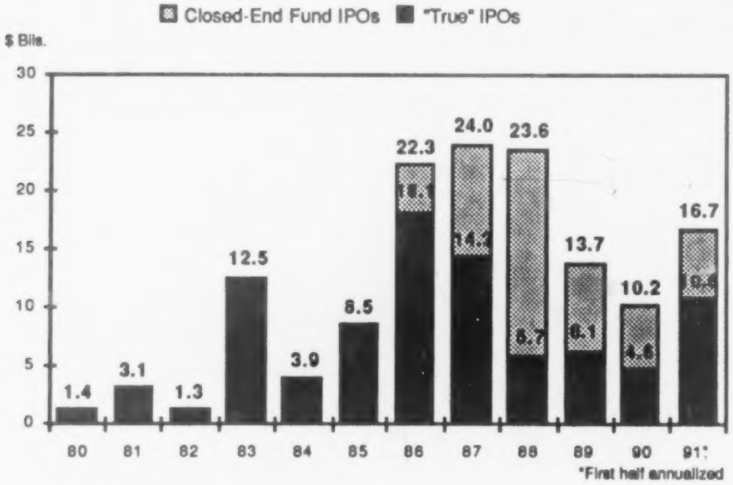
COMMISSIONS' SHARE OF INDUSTRY REVENUES



Today, commissions account for only 16% of total industry revenues. Total commission *dollars*, however, did not decline until after the 1987 Crash. What occurred was an explosive growth in other business line revenues relative to the slow growth in commission business. The decline in the relative importance of the commission business, a safe agency line of business, forced firms to seek profitability through more risky, principal lines of business such as trading, mergers & acquisitions, merchant banking, etc.

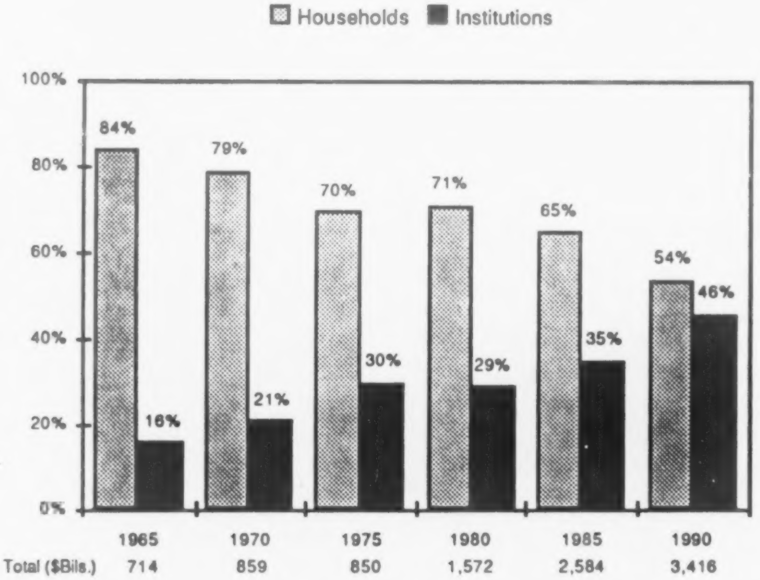
For new companies trying to raise capital via initial public offerings (IPOs) of stock, the 1987 Crash was an unqualified disaster. In the three years immediately following the crash, the total of "true IPOs" (exclusive of closed-end fund IPOs) raised over the entire three years (1988, 1989 and 1990) was less than that raised in 1986 alone. Over $5 billion in true IPOs have already been offered in the first half of 1991, more than was done for *all* of last year ($4.6 billion).

INITIAL PUBLIC OFFERINGS



In 1965, households held 84% of equities outstanding, and institutions 16%. By 1990, shareownership by individuals had dwindled to 54%. The "institutionalization" of the marketplace can be seen in the growing share of equities held by institutional investors, which has broad ramifications for market liquidity, volatility, etc.

HOLDINGS OF U.S. EQUITIES



By 1990, private pension funds held 40% of all institutional holdings of equities in the U.S. To give some idea of the difference in holdings of the two largest categories, individuals held $1.9 trillion while pension funds owned $0.6 trillion of equities. After private pension funds, public pension funds, mutual funds, and foreign investors are the next largest institutional holders of U.S. equities. Still, stock market trading is dominated by institutions because of higher turnover of their portfolios. According to our figures, institutions account for 70% of volume on the NYSE.

Well over a half a trillion dollars worth of equity in U.S. corporations was taken out of the stock market since 1984 through LBOs, other mergers and acquisitions, and other corporate restructurings. Many believe that this reduced supply of equities helped buoy the strong upward rally in stock prices throughout much of the 1980s.

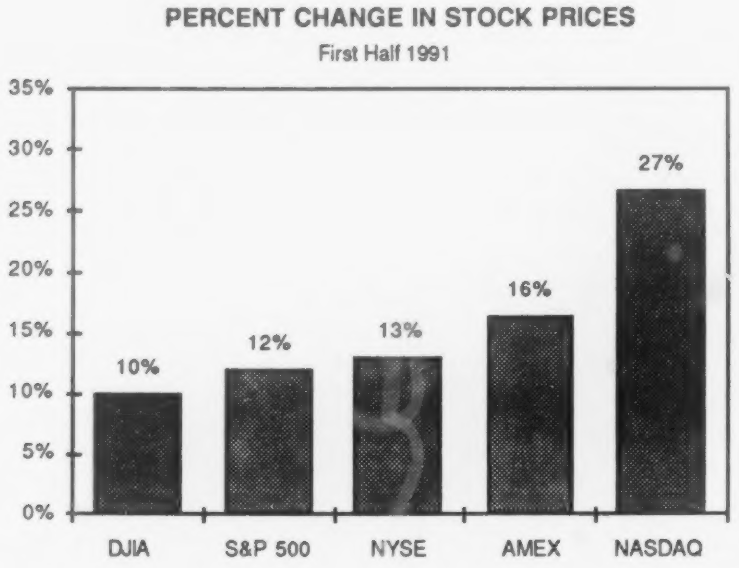
NET ISSUANCE OF SECURITIES
(New Issues Less Retirements In $ Billions)

	Corporate Equities	Corporate & Foreign Bonds	Total U.S. Government Securities
1970	7.7	23.3	21.7
1975	10.9	36.7	94.9
1980	14.9	30.5	122.9
1981	(10.5)	34.3	133.0
1982	7.9	39.0	225.9
1983	27.3	37.7	254.4
1984	(69.8)	84.2	273.8
1985	(67.2)	128.2	324.2
1986	(72.2)	212.8	369.5
1987	(63.0)	165.7	317.5
1988	(125.3)	161.5	277.2
1989	(105.1)	115.8	302.6
1990	(49.7)	126.7	443.1
1991*	11.2	132.4	370.7

*First Quarter Annualized

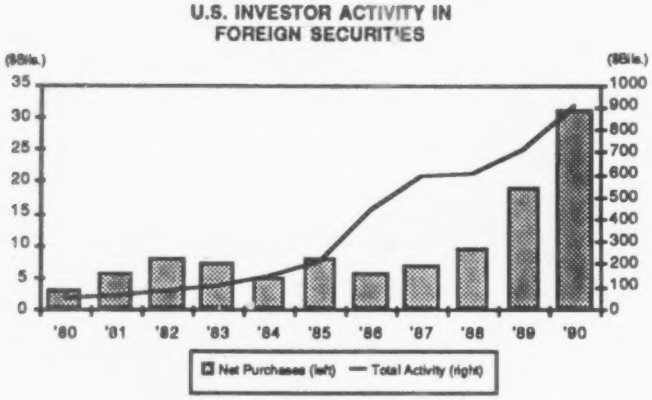
That this equity was replaced with debt, on top of the escalated borrowing of the U.S. government to finance increasing deficits remains a real concern to many economists and businessmen insofar as the recovery of the economy and markets is concerned. Fortunately, in 1991, for the first time since 1984, there has been an increase in the supply of equity, a sharp contrast to the trend since 1984.

After a year (1990) which saw all major stock market indices decline anywhere from 4% on the Dow Jones Industrial Average to nearly 20% on the American Stock Exchange and NASDAQ Composite Indices, 1991 so far has seen market levels rise strongly across-the-board. The Dow was up 10% in the first half, erasing last year's loss and then some, while NASDAQ was up 27% reflecting the strong institutional and retail interest in smaller capitalized companies. All other major indices were also up somewhere between these two ranges.

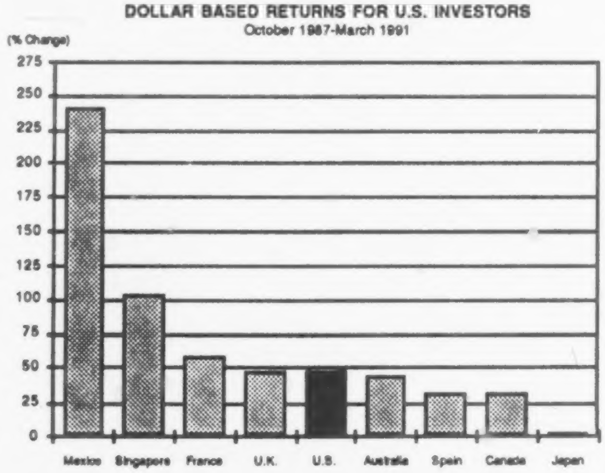


For much of the 1980s, U.S. interest in foreign securities was nowhere near the interest foreigners had in U.S. securities. For example, during the period 1980-1988, net purchases by U.S. investors in foreign securities averaged \$6.5 billion. In 1990, net purchases reached a record \$31 billion, following a then record \$19 billion in 1989. The increased U.S. interest was a function of several variables, including the expectations for Europe 1992, developments in Eastern Europe, strengthening foreign currencies relative to the dollar, and finally U.S. institutions taking seriously a stated long-term goal: namely, greater portfolio diversification.

The appetite of U.S. investors for different foreign securities changed recently. In 1989, U.S. investors had record net equity purchases of \$13.1 billion while net foreign bond purchases totalled \$6.0 billion. In contrast, in 1990 there were record U.S. purchases of foreign bonds of \$22.4 billion while net equity buys fell to \$8.4 billion.

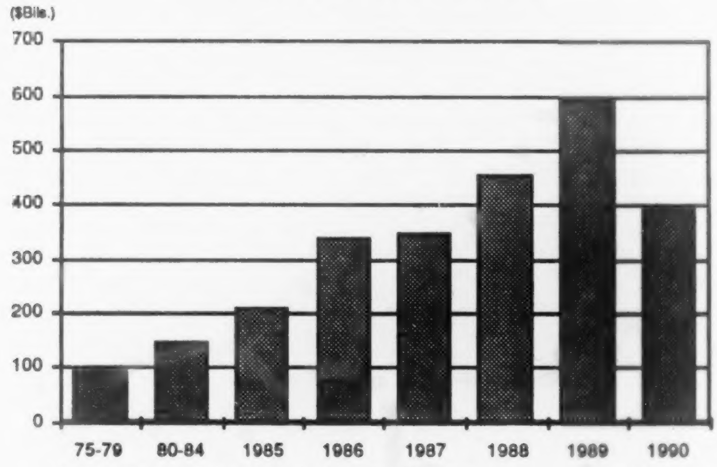


Mexico and Singapore led the markets in terms of dollar based returns since the Crash. Among the developed markets, France, the U.K. and the U.S. were the best performing markets. Except for Mexico and Singapore, the returns in the equity markets have been unimpressive and may explain many of the problems of the securities industry throughout the world in trying to attract investors, particularly when real interest rates were at record levels, especially in the U.S.



A recent Bank for International Settlements (BIS) report indicates that cross-border gross capital flows increased substantially through the 1980s. This basically was a reaction to deregulation, internationalization and technology. In recent years, countries with large and persistent occurring account deficits continue to attract foreign capital (unlike earlier years), thus weakening pressures for policy adjustments. Nowhere was this more true than in the U.S., where foreign capital substituted for savings and internal investment.

GROSS CAPITAL OUTFLOWS

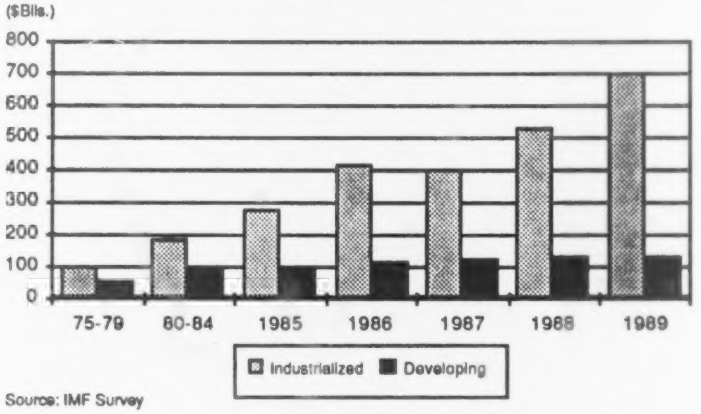


Sum of direct investment, portfolio, and long-term bank lending

Source: IMF Survey

The same BIS study indicates that it was mainly the developed or industrial countries that reaped the benefits of capital inflows in the 1980s. The amount of money going to the emerging markets held more or less stable since early 1980. The increase in flows to developed countries was a combination of increased portfolio investment and direct investment offsetting declines in bank lending.

CAPITAL INFLOWS TO INDUSTRIALIZED & DEVELOPING COUNTRIES



Source: IMF Survey

Developing countries may have to do a lot to improve the efficiency of their markets as well as to liberalize investment policies in order to encourage the kinds of portfolio flows (a more mobile form of capital than bank loans) that are needed given the sharp plunge in overseas bank lending in recent years.

Conclusion

Although much of the publicity about the securities industry in the 1980s revolved around mergers and acquisitions, LBOs, and direct investments in corporations, the actual time span that these activities dominated industry profitability was fairly short. In 1987-1989, these activities flourished. The same misconception is often made about mutual funds because equity mutual funds dominated other funds for several years. Only in the middle 1980s did equity mutual funds increase more than money market and bond funds. After the Crash, investment in equity mutual funds was actually negative as individuals switched out of equities into bond and money market funds. As short-term rates remained high in the U.S., individuals had little incentive to switch from short-term maturities such as money market funds. This behavior changed noticeably when the Federal Reserve reduced interest rates in late 1990 and February 1991 and in early August, as short-term rates lowered substantially while long-term rates remained relatively high.

If we analyze the industry's profitability during the 1Q91, it was attributable almost solely to a dramatic surge in trading profits and an increase in commission revenue. Costs remained controlled mainly because interest expense, the single largest expense of the U.S. securities industry, was more or less constant as interest rates were declining in 1991. This demonstrates how volatile the securities industry is as both trading and commissions, the main revenue sources of the industry in the 1970s and early 1980s, were flourishing in 1991 while the new products that accounted for much of the profits in the 1980s, had not recovered by mid-1991.

One of the main businesses that rebounded was raising capital for companies going public for the first time. If the 1991 pace continues, the amount of money raised for IPOs will be close to the peaks reached in 1986 and 1987. In any event, this is a healthy sign that the U.S. equity markets can respond to new and dynamic companies under appropriate conditions.

Finally, after a year where all the major stock market indices declined from 4% on the Dow to nearly 20% on the American Stock Exchange and over 27% on NASDAQ; in

1991, market levels have risen strongly across-the-board so far. The Dow was up 11% in the first half, more than erasing last year's loss. NASDAQ is up 27% reflecting the strong institutional and retail interest in smaller capitalized companies. All other major indicies were up somewhere between these two ranges. Hopefully, these trends will continue, helping the U.S. securities industry prosper.

Jeffrey M. Schaefer
Senior Vice President &
Director of Research

Grace Toto
Research Associate

VOLUME

	JUNE 1991	YTD 1991	JUNE 1990	YTD 1990	% CHG YTD 1991-1990
AVERAGE DAILY SHARE VOLUME ON					
NYSE (MILS.)*	163.0	183.4	153.6	155.8	17.7%
AMEX (MILS.)*	11.5	13.1	12.4	14.0	-6.6%
NASDAQ (MILS.)*	142.7	162.0	150.1	139.2	16.3%
REGIONAL EXCHANGE (MILS.)*	25.1	28.5	24.3	24.9	14.6%
DOLLAR VALUE OF SHARES TRADED ON					
NYSE (MILS.)	$112,457	$764,267	$115,622	$687,021	11.2%
AMEX (MILS.)	2,972	18,604	3,169	20,230	-8.0%
NASDAQ (MILS.)	46,976	327,210	44,887	242,182	35.1%
NYSE BLOCK VOLUME AS A PERCENT OF TOTAL SHARES TRADED	49.8%	49.9%	49.9%	50.1%	----
CONTRACTS TRADED (THOUS.)					
CBOE OPTIONS	8,593	64,857	10,745	64,443	0.6%
AMEX OPTIONS	2,284	16,551	2,544	17,947	-7.8%
COMMODITY	21,773	131,344	22,004	139,747	-6.0%

*MONTHLY AVERAGE
N/A - DATA NOT AVAILABLE

PRICES
(END OF MONTH)

	JUNE 1991	JUNE 1990	% CHG JUNE 1991-1990
DOW JONES INDUSTRIALS	2906.75	2880.69	0.9%
STANDARD & POOR'S 500	371.16	358.02	3.7%
NYSE COMPOSITE	203.47	195.48	4.1%
AMEX MARKET VALUE INDEX	358.12	361.21	-0.9%
VALUE LINE COMPOSITE	234.36	245.97	-4.7%
NASDAQ COMPOSITE	475.92	462.29	2.9%

YIELDS
(MONTHLY AVERAGES)

	JUNE 1991	JUNE 1990	BASIS POINT CHG 1991-1990
BOND BUYER INDEX (20 BOND)	7.13%	7.24%	(11)
CORPORATE BOND YIELDS (MOODY'S)			
Aaa CORPORATE	9.01	9.26	(25)
Baa CORPORATE	9.96	10.22	(26)
RATIO Aaa CORPS. TO Baa CORPS.	0.90	0.91	(1)

UNDERWRITING

	FIRST HALF 1991	FIRST HALF 1990	% CHANGE 1991-1990
CORPORATE FINANCING (Gross New Issues - $ Mils)			
TOTAL	$262,100.2	$163,912.6	59.9%
Common Stock	$26,002.4	$12,891.5	101.7%
# of Common Stock Issues	374	247	51.4%
Preferred Stock	$6,006.4	$2,846.3	111.0%
# of Preferred Stock Issues	60	51	17.6%
Corporate Debt	$230,091.4	$148,174.6	55.3%
# of Corporate Debt Issues	1,030	663	55.4%
MUNICIPAL FINANCING (Gross New Issues - $ Mils)			
Negotiated	$53,196.7	$43,873.0	21.3%
# of Issues	2,700	2,269	19.0%
Competitive	$20,250.3	$16,214.5	24.9%
# of Issues	2,019	1,787	13.0%

Source: Securities Data Co.

RECENT INTERESTING READING AND STATISTICAL MATERIAL

Item	Description	Source
Report on Production & Earnings of RRs in 1990	This is a survey of retail and institutional production in 1990 as well as the earnings of salespersons. The 1990 edition is the 18th issue of this survey. The data is based on information provided by 57 SIA member firms. Information is provided on production, payout ratios, earnings, ticket size, branch manager earnings, etc.	SIA Survey Department Author is Pam Faber. Extra copies are available to the 57 participating firms at $50 per copy. For firms which did not participate, the price varies depending upon a firm's number of RRs and ranges from $250 to $625. For firms which are not SIA members, the price for the first report is $1400. Checks should be sent to: SIA, 120 Broadway, 35th Floor, NY, NY 10271
SIA Yearbook 1991-92	This issue of the yearbook is the 12th annual guide to the securities industry as represented by the SIA membership. The yearbook is a basic source document on individual firms and contains important aggregate information on the securities industry. Each year, the yearbook updates firm lists so that information is provided on SIA members owned partially or wholly by organizations not themselves involved in the U.S. securities industry, provides information on mergers and acquisitions involving SIA members and provides a list of firms that clear for other organizations. SIA members $65, non-member $100.	SIA 120 Broadway-35th Floor New York, NY 10271 Attention: Rosalie Pepe

Item	Description	Source
"The Silent Depression"	This article questions whether the standard definition of recession or depression in the U.S. -- two successive quarters showing declines in real GNP -- is appropriate anymore. The paper suggest that a different measure of recession or depression would be more appropriate -- the real income of the average worker or family. Real income is stressed because this measure covers living standards, and the standard of living is the best measure of economic progress. With a different measure of recession, the economic performance of the U.S. is less satisfactory. More interestingly, the paper discusses the reason for declines in our standard of living in the U.S.	Challenge Magazine July/August 1991 issue 80 Business Park Drive Armonk, NY 10504
Eastern Europe: The Wealth of Lessons	This paper discusses the ease or difficulty with which socio-economic changes can be introduced. The paper notes that there is friction brought about by major social changes. When these changes are taking place, friction is high. The paper's author is concerned that the post-communist transition from central economies to freer, market forces causes major frictions that have been overlooked where such changes were urged since 1989. Many economists assume that human adjustments to new economic rules will be swift and relatively simple. They often overlook the fact that human responses may be considerably slower and difficult in practice.	Challenge Magazine July/August 1991 issue 80 Business Park Drive Armonk, NY 10504
New York's Most Unjust Tax	The author argues that New York City's property tax rates are among the highest in the country, especially for apartments and commercial buildings. He also notes that these property taxes are regressive, destructive of the housing stock, and particularly troublesome for businesses especially new ones. In the current climate, the writer believes the New York's high rates actually may cost the city money. The author concludes that thoughtful reform of NY's property tax would cost the city very little and pay dividends in a short span of time.	New York City Journal 52 Vanderbilt Avenue New York, NY 10017 Telephone # 212/988-7300

Item	Description	Source
A Survey of Business	A special survey on how business in Europe will change now that 1992 is approaching quickly and January 1, 1993 is the scheduled date when everything is scheduled to change. The lengthy survey notes surprisingly that much of the backlash against Europe 1992 is coming from the leaders of European industry, who were supposed to be the strongest supporters of a single market. Topics covered include product standards, alliances in Europe against Japan and America, problems in eliminating protectionist policies, subsidization of State run businesses, etc. Must reading for individuals interested in the strengths and weaknesses of Europe 1992.	The Economist June 8-14, 1991 111 West 57th Street New York, NY 10010 Telephone # 212/541-5730
Americas Banking Muddle	This is a well written summary of recent initiatives in Congress to "reform" the U.S. banking structure. Congress hurriedly put together legislative proposals before the August break against the background of record bank failures, rising deposit insurance costs and the story of BCCI's doings. The article notes that three basic issues have been raised by America's deregulation of financial services over the past 15 years. First is whether banks can be made more solvent by letting them into different businesses such as securities and insurance. The second is how to finance the almost limitless deposit insurance program and the third is how to disentangle the batch of many bank regulators. Although the insolvency of the deposit insurance fund is supposedly at the heart of the debate covering banking reform, the proposals are the least radical in this area. Basically, they try to make it cheaper to force troubled banks into bankruptcy. The Senate Banking Committee apparently wants to make it clear that after 1995 no bank will be considered too big to fail. Given the banks limited success in getting additional insurance powers and the problems non banks will have in owning banks under the Senate proposal, the writers believe there may be little chance for legislation this year.	The Economist August 10-16, 1991 111 West 57th Street New York, NY 10010 Telephone # 212/541-5730

Item	Description	Source
The Reckoning	This article covers the recent political and economic scandal in Japan. It notes that basically 17 Japanese securities firms have admitted that they paid clients to cover the clients' losses in the stock market Crashs of 1987 and 1990. The government is now working on legislation to tighten up Japan securities laws in the extraordinary session of Parliament that started on August 5. The practice of offering compensation for losses was claimed by the Ministry's securities division to be improper but not illegal. The Japanese tax authorities are taking a different view. The two methods used to compensate clients were dealing in Japanese government bonds at favorable prices higher or lower than appropriate market prices or buying back warrants at inflated prices in London. The drafted revision of the securities law would ban compensating customers for losses whether promised or not. It would be illegal both for investors to receive compensation and for securities firms to pay it. The article notes the momentum now being established calling for an independent watchdog in Japan like America's Securities and Exchange Commission.	The Economist August 10-16, 1991 111 West 57th Street New York, NY 10010 Telephone # 212/541-5730
SIA 1991 Fact Book	Second annual directory offering a decade of data covering global and domestic capital markets and the securities industry in general from 1981 to 1990. The Fact Book provides answers to the most frequently asked questions on the securities industry, stock exchanges, brokerage firms, mutual funds, futures and options, retail and institutional trading and holdings, economic data and foreign market statistics.	SIA 120 Broadway-35th Floor New York, NY 10271 Cost: $25 SIA members; $50 for non-members.

A8825-1

Securities Industry

TRENDS

An Analysis of Emerging Trends in the Securities Industry
Produced by the SIA Research Department

Vol. XVII, No. 5 October 15, 1991

BACK IN THE BLACK

First Half 1991 Securities Industry Profitability

Highlights

1. Based on first half results annualized, the securities industry is on target to match 1986's record pre-tax profit of $5.5 billion on a record $60 billion of revenues. Boosting the climb, retail-oriented firms performed exceptionally well...across the board.

2. National Full Line firms, Regional firms and Discounters are all headed toward a record profit year. Even the Large Investment Banking firms and other capital market-oriented firms, such as New York City-based Regionals, are close to tying their prior record profit year. Of course, profits are a different measure than ROE.

3. Consolidation in the securities industry appears to have bottomed out during first half of 1991. By mid-year, the number of NYSE members seems to have stabilized and the shrinking employment trend finally slowed down, and may even have reversed according to the raw data.

4. Almost all business segments generated vastly improved revenue across the board this year relative to a poor 1990. On an annualized basis, 1991 shows improvements of about 16% in commissions; 18% in trading, and 40% in underwriting (55% in equity underwriting revenue). Only margin interest and commodity revenues declined.

5. Although private placement volume has been almost cut in half the past two years, the one growth area is the new Rule 144A private offerings. Big names from several continents which have tapped this market to date include: British Aerospace, Toyota, Sony, Samsung, BMW, etc.

6. Every major expense category except compensation, which is linked in many cases to production, showed further dramatic declines this year. Cost cutting, initiated since the crash, is still having an impact during 1991.

Securities Industry Association

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BACK IN THE BLACK

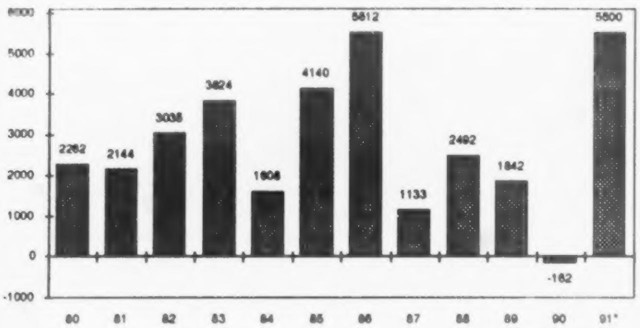
Finally, bottom line black ink is back on the securities industry's income statement. After three years of frightful financials, the sturdy profits posted on securities firm quarterly P&Ls this year was a welcome relief.

Annualized first half earnings paint a promising pictorial (see following charts). Although the hazy, lazy days of summer tempered certain earnings streams' previous pace, the annualized results still project a resurrection of industry profit potential. The 322 NYSE member firms dealing with the public (also referred herein as "all firms" or "total industry") are on target to match 1986's record profits of $5.5 billion, pre-tax, although five years later. Boosting the climb, retail-oriented firms performed exceptionally well...across the board.

The National Full Line Firms not only ended a four-year fiasco, as a group they're on target to outdistance their all-time record profit year, 1986. A similar scenario is being painted by the Regionals. If their second half profits match their first, it would lock in an impressive year-to-year profit rebound; again, breaking their 1986 record.

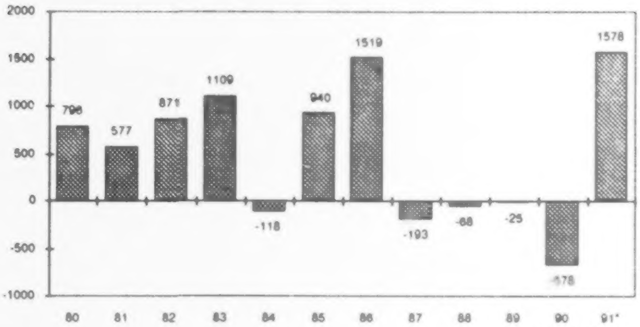
Meanwhile, the Discounters are on an unbelievable roll. Their first half profits are already 24% ahead of last year's *full-year* profits and nearing the total for their best ever full-year results (again, 1986). If momentum's maintained, 1991 would show profits nearly double that of 1986.

The institutional firms are also basking in a banner year, though the first half profit pace is just shy of a record stride. The Large Investment Banking Firms' (LIBs) first half gait could produce over a four-fold annual profit increase and place 1991 second on their record books. Similarly, the New York City-Based Regionals are also heading toward their next to best ever profit year compared to 1990's negative returns.



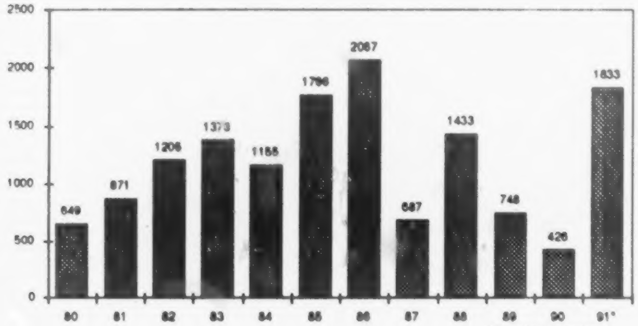
ALL NYSE FIRMS
Pre-Tax Profits

*First Half Annualized



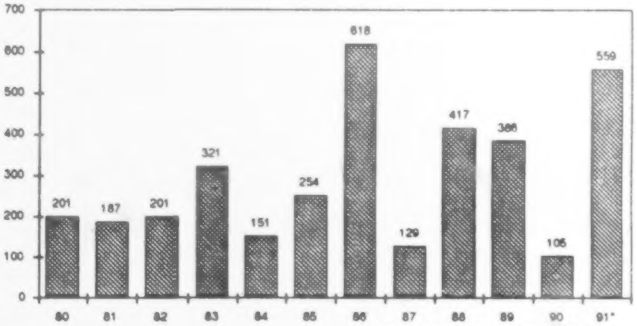
NATIONAL FULL LINE FIRMS
Pre-Tax Profits

*First Half Annualized



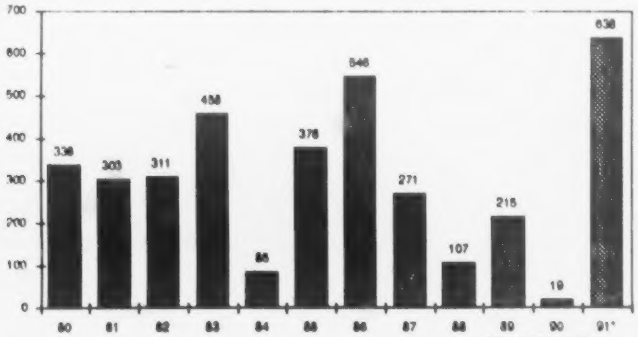
LARGE INVESTMENT BANKING FIRMS
Pre-Tax Profits

*First Half Annualized



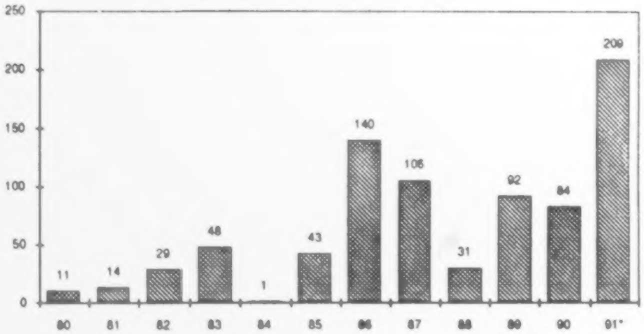
NEW YORK CITY-BASED REGIONAL FIRMS
Pre-Tax Profits

*First Half Annualized (firms recategorized in 1991)



REGIONAL FIRMS
Pre-Tax Profits

*First Half Annualized



NYSE DISCOUNTERS
Pre-Tax Profits

*First Half Annualized

BOTTOMING OUT

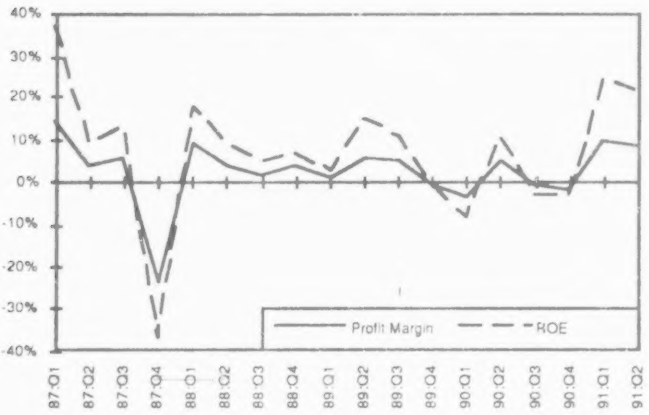
But before we march down optimistic primrose paths, a reflection on the industry's sobering, and very recent, past is in order. As reported in the April 9 issue of *Trends*, last year was the worst on record for the securities industry. Some sobering reminders include: NYSE member firms posted a record $162 million pre-tax loss, the first annual red ink since 1973. The only profitable quarter last year was Q2. The industry's equity capital fell to the lowest level since 1986; total capital fell to a post-crash nadir. Securities industry employment contracted 20%, to 1984 levels, in just three years' time.

Further, commissions declined each quarter last year, bottoming at a mere $2 billion in Q4 — the same level earned quarterly from late 1982 to early 1984. For the year, commissions were down 13% from 1989, a sharp 30% below 1987's peak, and were barely 16% of total revenue. The number of NYSE member firms dealing with the public contracted to the lowest on record while NASD membership fell to 1984 levels. That's the bad news (or some of it).

The good news, as we've seen, is that the bad news finally "bottomed out." The industry's 1991 first quarter pre-tax profits of $1.4 billion was the best showing since first quarter 1987. The second quarter's $1.3 billion profit was almost as strong as Q1. In stark contrast, prior to this year, the industry incurred pre-tax losses in four of its past five quarters. The profit rebound was the direct result of three years of cost cutting combined with a surge in primary and secondary market trading volumes.

On the margin, profitability showed healthy increases also. Pre-tax profit margins and return on equity (ROE) of 9.5% and 24.6%, respectively, in Q1 and 8.8% and 21.4% in Q2, were the best since 1Q-87 also (see following chart). The first and second quarters were also the 6th and 8th best quarters ever in terms of total profits.

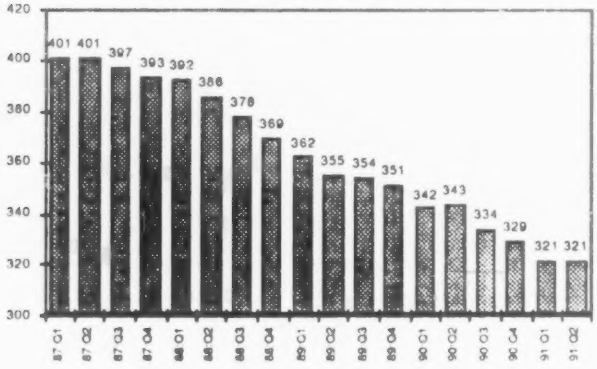
PRE-TAX PROFIT MARGIN & RETURN ON EQUITY



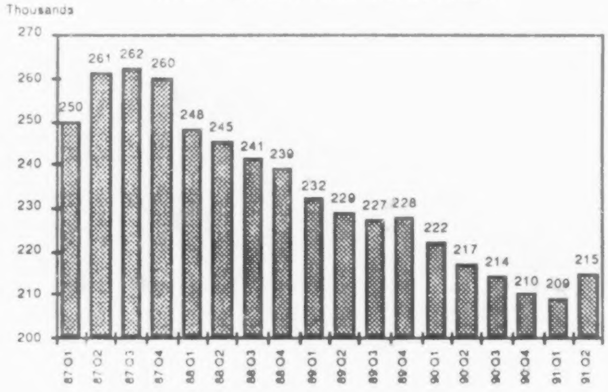
Of course, when 1991's bull market arrived, it was to a leaner, and more compact, securities industry. The number of New York Stock Exchange member firms, and the employees working for them, contracted 20% since the crash. That's a loss of one out of five firms and one out of five jobs. Even a broader-based measure, the number of NASD member firms, shows a similar 18% decline, from just over 6,700 firms in 1987 to about 5,500 this summer.

NYSE MEMBER FIRMS

(Doing a Public Business)



NYSE MEMBER FIRM EMPLOYMENT



This level of consolidation translates into fewer seats at this year's banquet table...everybody's plate was that much fuller. And while the revenues and profits of the best year in a while can now be divvied-up among fewer firms, many firms also have smaller payrolls and overhead to charge against these earnings.

NYSE BROKER-DEALER INCOME STATEMENT

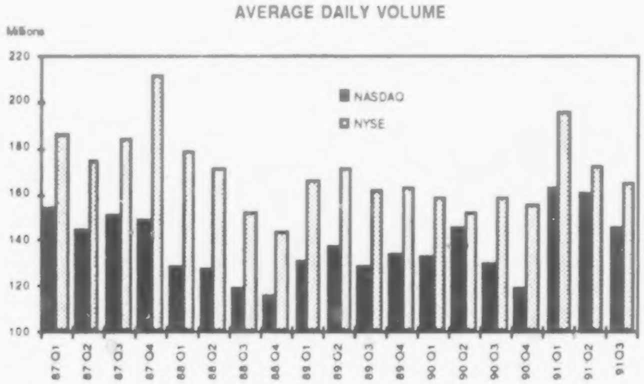
(In $ Millions)

REVENUE:	**1990**	**1991***	**90-91* % Change**
Commissions	8,878.1	10,614.6	19.6%
Trading Gains	13,175.0	15,976.8	21.3%
Investment Gains	-283.1	1,014.0	NM
Underwriting Revenue	3,243.3	5,312.2	63.8%
Margin Interest	3,075.3	2,596.4	-15.6%
Mutual Fund Sales	1,669.1	1,905.2	14.1%
Fees, Account Supervision	2,241.0	2,381.8	6.3%
Research	18.4	20.8	13.0%
Commodities	1,685.8	1,279.4	-24.1%
Other Securities Related	17,389.3	16,106.0	-7.4%
Other Unrelated	2,941.5	3,018.2	2.6%
TOTAL REVENUE	54,033.7	60,225.4	11.5%
EXPENSES:			
Total Compensation	17,715.2	20,498.0	15.7%
RR Compensation	6,867.6	8,257.6	20.2%
Clerical Compensation	8,789.3	9,906.0	12.7%
Floor Costs	1,731.0	1,745.6	0.8%
Communications	2,221.7	2,117.0	-4.7%
Occupancy & Equipment	3,092.2	2,920.6	-5.5%
Promotional Costs	878.4	827.0	-5.9%
Interest Expense	22,717.2	19,974.6	-12.1%
Errors, Bad Debts	296.3	347.0	17.1%
EDP	684.6	665.4	-2.8%
Regulatory Fees	427.7	443.2	3.6%
Non-Recurring Charges	389.5	44.2	-88.7%
Other	4,041.7	5,143.0	27.2%
TOTAL EXPENSES	54,195.5	54,725.6	1.0%
PRE-TAX NET INCOME	-161.8	5,499.8	NM

Source: SIA Securities Industry DataBank **First Half Annualized*

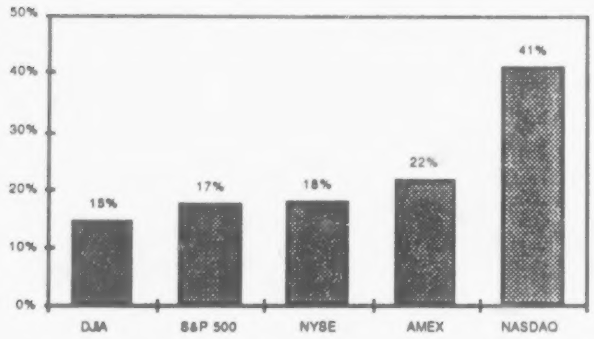
EQUITY WAS KING

As seen in the preceding table, most business segments, virtually across the board, generated vastly improved revenue this year. A half-year of investor uncertainty, and resultant investment indecision, regarding the U.S.-Iraq-Kuwait situation evaporated overnight.. the night of the Baghdad blitzkrieg. The few fence-sitting stragglers toppled off their perches and back into the market when, and as swiftly as, the allies advanced on enemy ground. Within days, it was clear that equity was again king. Commissions jumped 33% during this first quarter to a post-crash high of over $2.7 billion. Granted, it was rising off a fourth quarter 1990 post crash-nadir, a low not seen since the early 1980s. Nevertheless, the rising secondary markets and increased volume were impressive and gave much of the industry's other business lines a high voltage jump-start.

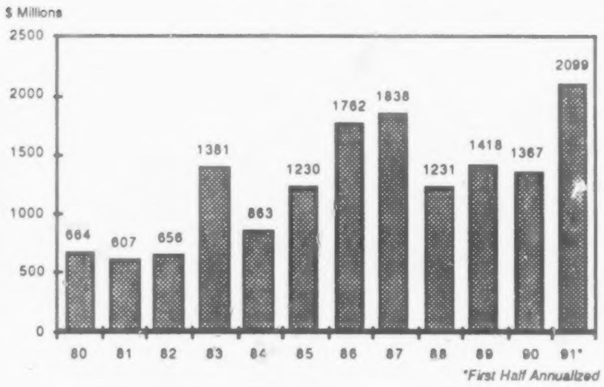


As seen above, the heady volume in 1Q-91 led to the sharp uptick in commission revenues. Second quarter volume dissipated somewhat, as did commission revenue (down slightly to $2.6 billion), but was still the best business in quite a while. Stock prices also got boosted during the buying spree, bringing equity-starved corporate issuers, long on the sidelines, back on the road to issuing equity.

The phenomenal rise in the smaller "cap" NASDAQ market in 1991 led to record quarterly gains in OTC market making. The NASDAQ Composite Index booked a 41% gain from January to September, double the also impressive 17-18% average gains on listed issues. On an annualized basis, OTC trading gains will exceed $2 billion this year, 53% ahead of last year's pace and 14% in excess of 1987's record level.

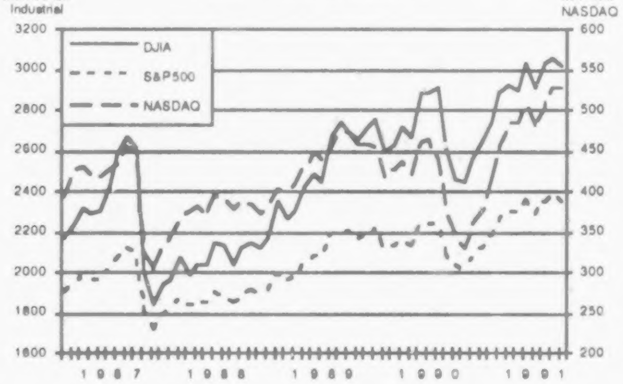


1991 NINE MONTH STOCK PRICE INCREASES

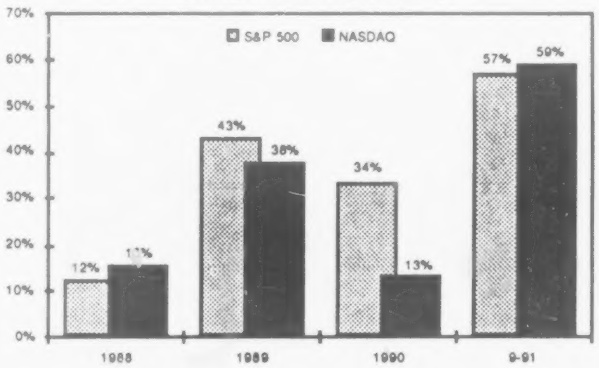


OTC TRADING GAINS

In fairness to listed issues, however, over-the-counter stocks were mostly playing catch-up with their higher cap brethren this year.* The NASDAQ Composite was up only 13% from the end of 1987, right after the crash, through the end of last year vs 34% for the Standard & Poor's 500. The culprit was 1990's brutal bear market which pummeled all equities but particularly smaller, over-the-counter issues. Through September of this year, the S&P 500 and NASDAQ indices are both almost 60% above their 1987 closing prices.



STOCK PRICE INDICES



PERCENT CHANGE IN STOCK PRICES

(From 12/31/87 to end of period shown)

As mentioned, 1991's phenomenal equity price level increases, often 20% to 40%, jump started a exceptional level of equity offerings. Enticed by the best P/Es in years, and burdened with high debt to equity ratios, corporate CFOs began funding their financing needs in the equity markets at a pace not seen since the mid-Eighties.

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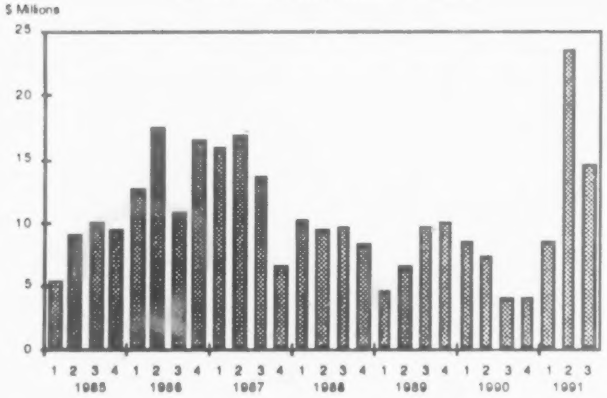
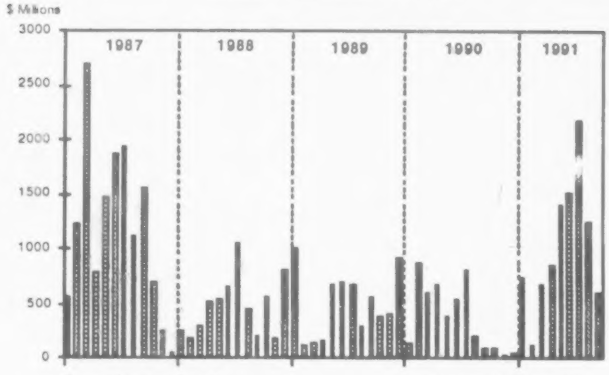
* See SIA's *Investor Activity Report*, August, 1991, for fuller details.

EQUITY UNDERWRITING VOLUME



INITIAL PUBLIC OFFERINGS*



Source: Securities Data Co.

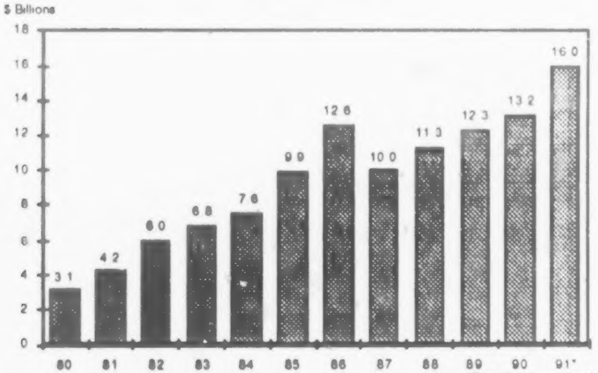
*Excludes closed-end bond funds

Meanwhile, start-up companies, caught in a double squeeze from the bank credit crunch while simultaneously being shut out of equity markets since the crash (from prohibitive dilutions and investor disfavor), came storming in with initial public offerings at near-record monthly clips.

DEBT's OWN THRONE

While equity was king this spring, debt was perched on a throne of its own. An accommodating Federal Reserve Board of Governors, more worried about impending recession than distant inflation, kept the discount window wide open while lowering bit by bit its lending rate. The result was a royal bond market rally.

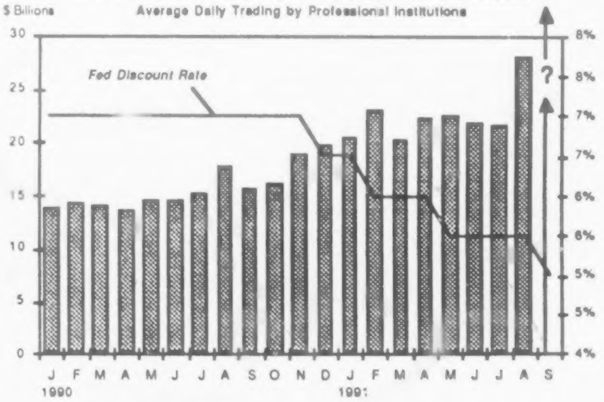
TRADING GAINS



*First Half Annualized

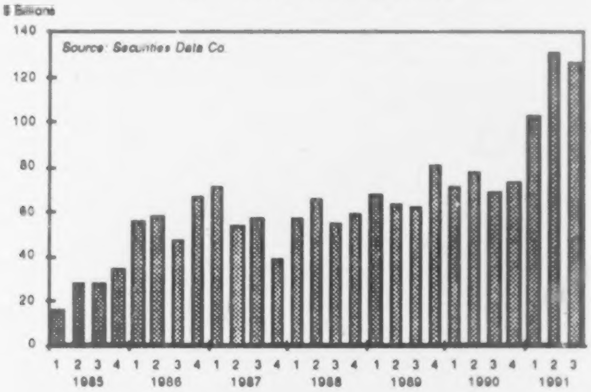
SECONDARY TRADING OF CORPORATE BONDS

Average Daily Trading by Professional Institutions



At the pace set in the first half, all trading gains are headed for a record year. Since the bulk of these gains are from debt trading, and since the Fed lowered the discount rate again in September, to 5%, its lowest level in 18 years (with widespread speculation of further easing to come), the record pace should hold all year. Again, the benefits were not felt solely in the secondary markets. Also, corporate bond underwritings this year are running nearly double the average of the past few years.

CORPORATE DEBT ISSUANCE



Source: Securities Data Co.

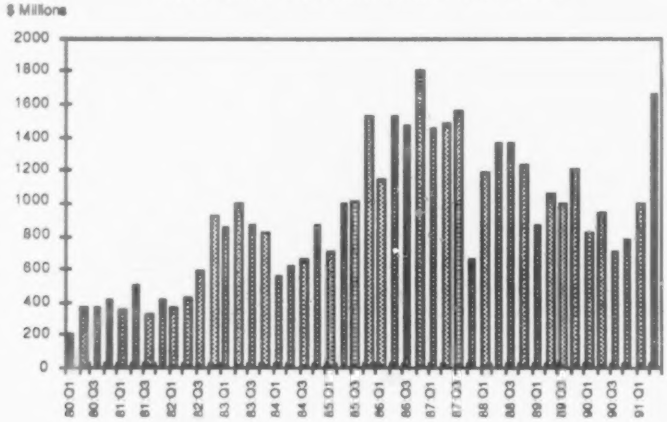
SYNDICATE BONANZA

After the first quarter set a record for volume of new issues, the second quarter broke that record...both for total volume and for debt and equity volumes. As mentioned, the outlook for the second half is superb -- third quarter underwriting volume is the second best ever and only a shade below the second quarter's record total. With the Fed contemplating another downward rate move on top of its recent easing, CFOs will be sorely tempted to initiate some serious bond refundings. Also, syndicate department equity calendars are becoming fully booked again, signalling a strong fourth quarter, at least until the perennial year-end holiday slowdown.

Of course, corporate syndicate departments and the industry's income statement were direct beneficiaries of this activity. Total underwriting revenue rose 30% in the first quarter to $1 billion and an additional 40% in the second quarter to $1.7 billion, the second highest ever. Nearly $600 million of the second quarter's total was from equity underwriting, by far the most ever booked in a quarter and well over double recent quarterly averages.

The major bracket firms still command the lion's share of all syndications, nearly 90% of the volume by the top 10 underwriters, but this year's action was so heady that it spread the bonanza all the way down to the bottom bracketed firms. In fact, many Regional firms' second quarter profit boosts were principally from underwriting, although mutual fund sales also helped while commission revenue eased slightly from the first quarter's highs.

INDUSTRY UNDERWRITING REVENUE



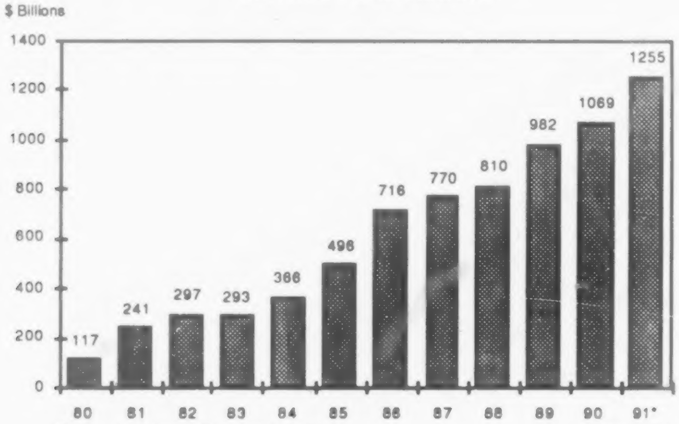
And though the focus here is on domestic markets, the securities industry was similarly rewarded by a capital markets boom worldwide. Global issuers pushed 1991's nine-month totals for Eurobonds and international equity sales to the brink of 1989's full-year volume records for these markets. And, as an upcoming issue of SIA's *Foreign Activity Report* will show, the global party is not limited to just the capital markets arena. Domestic commission revenue growth is being partly fueled by a growing appetite of U.S. investors for foreign equities. By May, U.S. investors had snapped up more foreign stocks than they had previously in any full-year.

MUTUAL FUND PHOENIX

With the return of the individual investor this year, came growth in all retail areas. We've already seen some of retail's impact -- commissions, OTC trading, and underwriting, as end buyers of equities and municipal bonds underwritten. However, as seen in previous issues of *Trends*, retail investors have gradually shifted a large portion of their financial assets toward managed accounts and away from direct investment and ownership.

Individual's directly hold just over half of U.S. stocks outstanding, down from 85% less than three decades ago. The lion's share of individuals' investment today is through professionally managed vehicles. A good portion of the household sector's total worth is vested in pension plans, mainly invested in stocks and bonds, even though individuals do not directly contribute funds nor partake in the subsequent investment decisions. But individuals have substantially increased the amount of savings which they direct to managed accounts, mainly mutual funds. According to the *Investment Company Institute*, total assets in mutual funds rose 1,000% in the past decade to $1.3 trillion.

MUTUAL FUND ASSETS

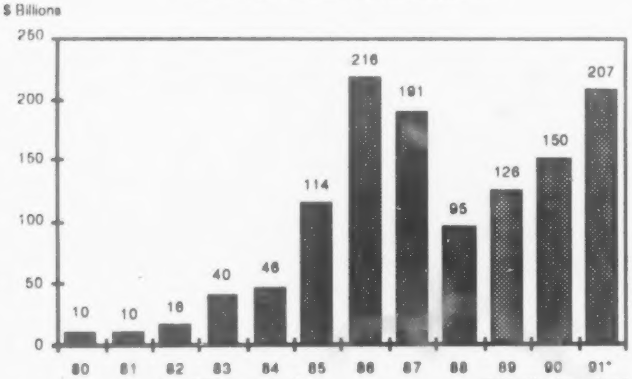


Source: Investment Company Institute

**August 1991*

Total sales of mutual funds peaked in 1986 and were headed through the roof towards a new record in 1987 when that nasty little event, October 19, came along. Post-crash, sales went through the floor. Net sales, purchases less redemptions, fell to almost "0" in 1988. As retail investors gradually wet their feet in the late-Eighties' equity market, sales of funds again ascended. As seen in the following charts, mutual fund sales are climbing toward their previous highs while revenue therefrom continues to mount.

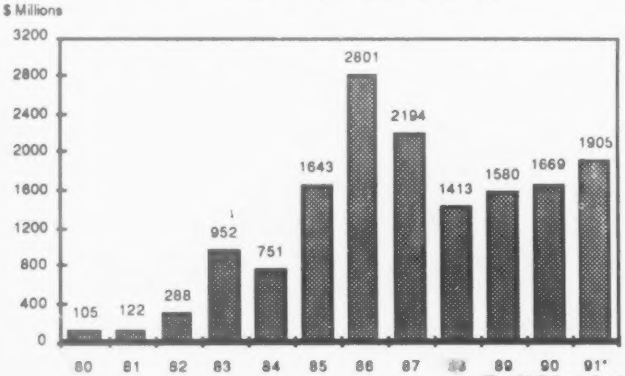
MUTUAL FUND TOTAL SALES



Source: Investment Company Institute

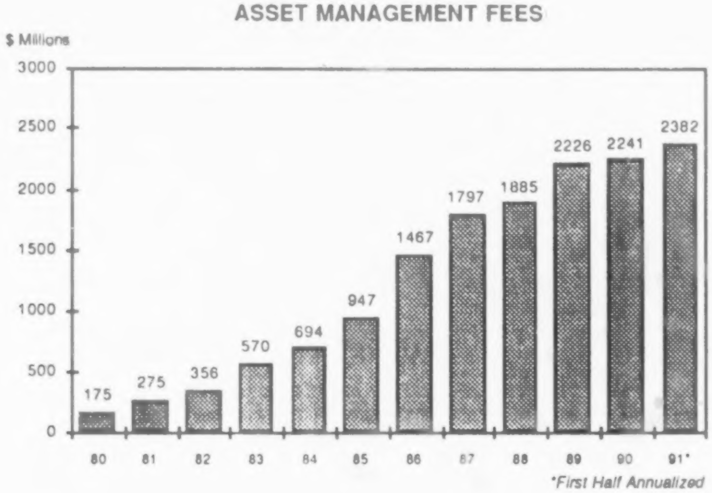
**8 Months Annualized*

MUTUAL FUND SALE REVENUE



**First Half Annualized*

Other managed accounts, particularly the popular and blossoming "wrap account," are being introduced by many firms in order to earn steady fee income while servicing client demand for professional investment management. The big assist that these fees are now giving the bottom line is depicted below in "asset management fee" revenue growth.

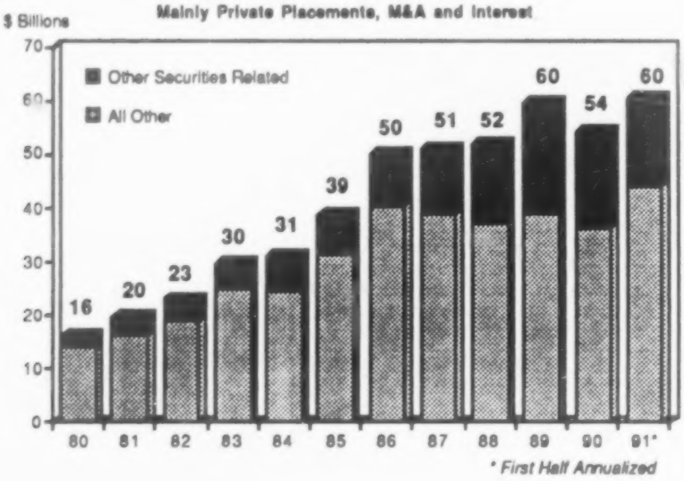


OTHER REVENUE RELATED TO THE SECURITIES BUSINESS

The importance of private placements, M&A fees, and interest income to the securities industry's profitability during the Eighties was enormous. As explained in previous issues of *Trends*, the securities industry's regulatory report (the FOCUS Report) does not allow for separate analysis of these categories – they are aggregated as one in the revenue line, "other revenue related to the securities business."

Let's look at these three revenue sources as one for a moment. The chart below shows that from 1980 to 1986, all sources of revenue were growing rapidly – total revenue exploded four-fold from $16 billion to $60 billion. Meanwhile, "other-related" revenue (privates, M&A and interest) exploded over five-fold, going from under $2 billion to over $10 billion from 1980 to 1986 (dark section of the bars below).

GROWTH IN IMPORTANCE OF
"OTHER SECURITIES RELATED" REVENUE
Mainly Private Placements, M&A and Interest

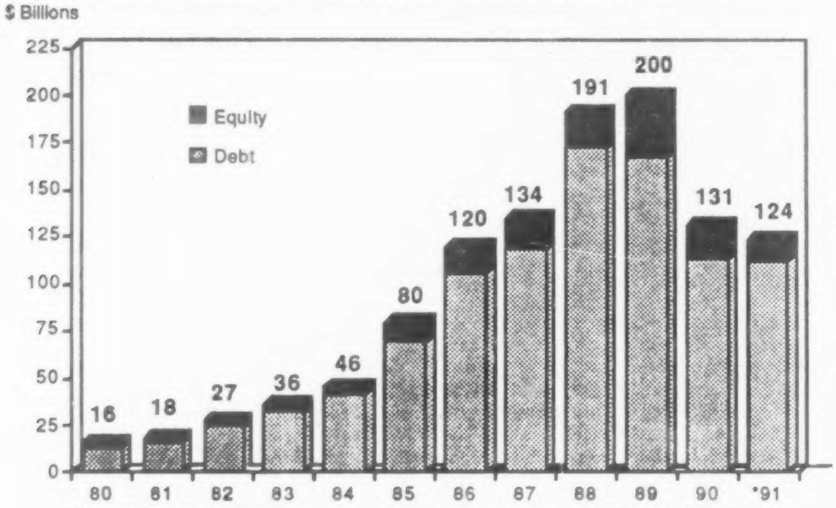


Over the next five years, through the end of last year, these three revenue sources accounted for *all* of the securities industry's revenue growth; in fact, all other revenue sources fell during this post-Crash environment. These same three revenue sources skyrocketed to over $20 billion by 1989 and equalled *more than one third of all revenue* for the securities industry. But the growth ended last year. These revenues fell to $17 billion in 1990 while this year they are running at an even lower $16 billion annual pace, down to 27% of total revenue.

This reversal of the long-term growth trend matches the trend reversal of the three same revenue components. Private placements, as we'll see in a minute, are down for the second straight year. M&A fees and junk bonds, their driving force, have also been stricken in recent years. Finally, interest revenue is now falling, partly due to the lowest interest rate environment in 18 years.

PRIVATE PLACEMENTS LOSE LUSTER

After decades of relative obscurity, the volume of domestic private placements (securities placed with large accredited investors and exempt from SEC registration) skyrocketed in the Eighties and crested at $200 billion in 1989. In just two years time, however, the volume of private placements has been cut nearly in half.



U.S. DOMESTIC PRIVATE PLACEMENT VOLUME

Source: Securities Data Co.

**First Half Annualized*

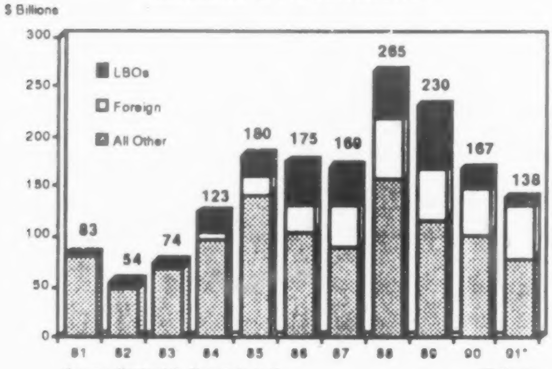
Several factors came together last year to assist in the 35% decline in private placement volume. Acquisition-related financings and junk bond offerings screeched to a virtual halt in late 1988. ESOP-related financings were curtailed by IRS rule-tightening. These areas of private placements all fell 50% to 70% in 1990. Further, issuers have favored the public markets in 1991. Both debt and equity public underwritings are reaching record levels this year. The annualized volume figures shown above may turn out to be too rosy -- indications are that private placements slowed substantially since the summer and 1991's final tally may be the lowest since 1985.

One growth area this year is the new Rule 144A private offerings. Since Reed International's $100 million note sale launched this market last April (after SEC adoption of the rule), the market's shown signs of taking off. About 14% of this year's private placement volume comes from 144A and a much higher 44% of all equity deals are completed under the ruling. One of the rule's intentions was to entice foreign issuers to bring to the U.S. private markets deals otherwise done overseas to avoid the added costs and time in U.S. registered public offerings. In this regard, it has been a success. Big names from several continents which have tapped this market to date include: British Aerospace, Toyota, Sony, Samsung, BMW, etc. Further, the British invasion at 144A's onset, while not over, is being supplemented by transactions from mainland Europe, Asia, and most recently, Mexico.

The 144A market was not the only area being fueled by foreigners. The only growth in merger and acquisitions (M&A) came from abroad. The LBO arena was dead for the second straight year. The reverberations from late 1989's shakeout in the junk bond market are still being felt today.

The downward sloping "other securities related" revenue line is impacted by the drop off in both previously mentioned subsectors -- private placement and M&A fees. However, the third component, interest, which probably accounts for 50% to 75% of the "other revenue line," is more difficult to track. Margin interest revenue, however, peaked in 1989 and has fallen just as steadily as "other revenue related," private placements and M&A. The balance of the interest question, both income and costs, is discussed below.

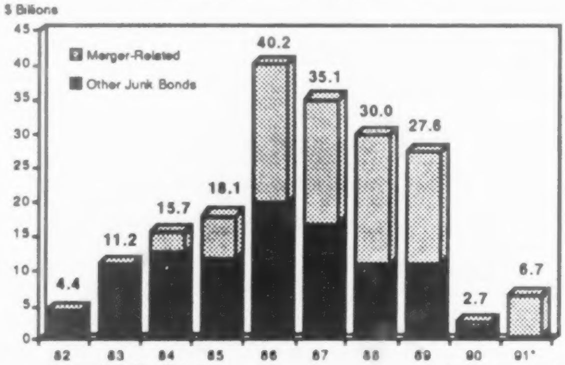
MERGERS & ACQUISITIONS



Source: Sanford C. Bernstein & Co

**Estimate*

JUNK BONDS UNDERWRITTEN



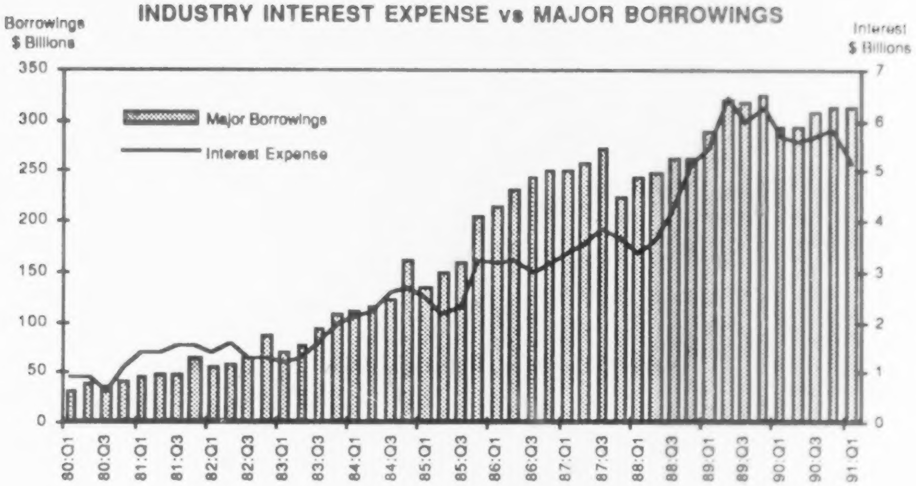
Source: Securities Data Co.

** Nine Months Annualized*

MANAGING INTEREST INCOME

Until 1989, gross interest expense was by far the fast rising cost item on the securities industry's income statement. Not only did gross interest expense rise six-fold in the Eighties, but from just 1Q-88 to 4Q-89 (and 1990), interest skyrocketed from 28% to 43% of total expenses. Until mid-year 1989, the major borrowing items on the industry's balance sheet (reverse repos, bank loans, subordinated debt, and notes and mortgages payable) likewise exploded to over $300 billion.

These liabilities were incurred to fund rapid expansion during the Eighties and were incurred in what was generally a deflationary, descending interest rate environment. During the largest interest cost escalation in 1988 and 1989, however, we were in a rising rate scenario.



Major borrowing levels were reduced early last year, as industry consolidation, firms closings and mergers, and cost control measures impacted the industry balance sheet. The reduced liabilities combined with falling interest rates reversed the perennially upward sloping interest expense line. This year's bull market witnessed an expansion in major borrowings to finance expanding business. Several interest rate reductions have kept gross interest costs in check. Naturally, any further rate cuts will keep this critical cost contained while a rising rate will spike up expenses.

Of course, interest expense is only one side of the coin. Securities industry management must manage interest income. Rising or falling interest rate environments can have various impacts on securities firm earnings. Rates certainly impact bond prices which affect investment gains & losses and trading profits; they also impact customer financing rates, borrowing costs, etc.

Although the raw data does not allow detailed analysis, it is widely agreed that falling rate environments are profitable for the securities industry and that the industry earns positive net interest income.

COMPENSATION COSTS

The industry's largest non-interest expense is compensation. Compensation costs averaged 40% to 50% of all costs (including gross interest) during the Eighties, up until the Crash. This cost item fell to 38% in 1988 and then to 33% in 1989 and 1990. So far this year, it is up to 38% of all expenses.

Part of the reason for 1989's and 1990's percentage drop is directly attributable to the explosion in interest and its resultant larger piece of the total expense pie. With gross interest expense netted out, over the past dozen years compensation accounted for 56%-61% of all other expenses (net expenses).

Cost control measures since the crash, particularly headcount related, had an impact. Prior to 1989, compensation was 60% of net expenses throughout the 1980s; last year it fell to 56%. Compensation also fell 6% to $17.7 billion, 13.8% below 1987's peak level of $20.6 billion. Employment was trimmed a higher 19.4% over this same time frame also.

This year, compensation is running at an annualized pace of $20.5 billion, a 16% jump from last year. Much of the increase is from higher RR payouts related to higher commissions. Both RR compensation and commission revenue are up 20% this year, on an annualized basis. All other compensation costs are up a lesser 13% this year.

RR compensation, adjusted for inflation, shows managerial controls even in this active year. The last two very active years were 1986 and 1987. In constant 1982 dollars, commission revenue (annualized and also adjusted to 1982 dollars) is running 22% below the 1986-87 average. Also, average employment this year is down 18% from the same period. However, annualized 1991 RR compensation is running 25% below average 1986 and 1987 RR compensation, adjusted for inflation.

"All other" compensation costs (those beyond RR comp) inevitably show large first quarter increases reflecting accrued year-end firm-wide bonuses paid out in Q1. This year was no exception -- all other comp rose 22% to just over $3 billion in the first quarter but eased sightly in Q2. Again, on an annualized basis, other compensation is running 13% ahead of last year, a tad above revenues' 12% growth rate.

Some of the increase in compensation, of course, came from the turnaround in securities industry employment. All "major groups" of firms, with the exception of the Large Investment Banks showed increased employment in Q2, the first upswing since the Crash. The net industry-wide gain was under 3%, a welcome respite, following 20% cuts the past three years, indicating that, at least, the industry consolidation and contraction may finally be over.

COST CUTTING STILL WORKING FOR OTHER MAJOR EXPENSES

Other than compensation, all other major expense areas are benefitting from the cost cutting programs implemented during the past few years. We've already seen how interest expense is still headed down. One area where competitive pressures have kept transaction costs down is total floor costs -- floor brokerage, commissions and clearance fees. After peaking at $2.2 billion in 1987, floor costs have been running at 1986 levels of $1.7 billion the past four years, even with 1991's much increased volume relative to the past three years.

Communications costs, EDP expenses, promotional costs, occupancy and equipment costs, each have straight-line downward trends since their peaks in 1987, including more improvement in the first two quarters of this year. Each is down about 5% (annualized) from 1990. These expenses can be tracked, budgeted and slashed, when necessary. Even occupancy costs, which often are fixed-budgets for years to come, have benefitted from the glut of office space. Of course, as mentioned earlier, the level of expenditures for these areas should contract solely from the consolidation in the number of firms since the crash.

Losses from error accounts and bad debt have returned to their historic low levels. Only the 1987 crash and 1989 mini-crash showed unusual upticks in loss accounts. Government, as always, does not lower its demands. In the tax area, state and city governments are becoming creative and pro-active in extracting more and more revenue from all service industries. Regulators, including state securities administrators, are taking a bigger bite each year. Regulatory fees will hit a record $443 million this year if the first half annual pace of 4% increases continue. This item only reflects what is reported on FOCUS but is useful in supporting a trend that industry observers are very sensitive to. Actually, last year was the only year where this expense fell -- a 2% decrease.

The long string of post-crash special charges seems to be over. Most of these non-recurring charges were associated with "one time" downsizing costs but also reflected special charges in other areas. All in all, total expenses for the year look flat, about the same as last year's $54 billion on an annualized basis. Considering the better business climate -- good vs disastrously poor -- the industry should be in good shape by the time the year winds down.

Management must, however, keep an ever present eye on costs. Where improvement can still be made is in the largest non-interest expense -- compensation. Over the past three years, much has been done in this area but these costs are on the rise again. Of course, more active markets and additional hiring necessarily puts upward pressure on this cost line. Still, the industry can continue to implement more profit-based (vs current revenue-based) compensation packages; tie compensation to firm-wide performance; use stock or phantom stock in lieu of cash bonuses; tie broker compensation to asset gathering and portfolio performance, and other packages now being tested or implemented. If this trend continues, and today's new-found grip on costs is not relaxed, industry profitability can only benefit.

George R. Monahan
Director of Industry Studies

NOTE

The format of the following *Trends* Statistical Section has been changed beginning with this issue. To improve its usefulness to our readership, we have provided more comprehensive information on the U.S. capital markets, stock market, and mutual fund activity.

If you have any questions or comments on the contents of the *Trends* Statistical Section, please contact Grace Toto at SIA, 120 Broadway, New York, NY 10271.

U.S. CORPORATE UNDERWRITING ACTIVITY

(In $Billions)

	Straight Corporate Debt	Con-vertible Debt	Asset-Backed Debt	TOTAL DEBT	High-Yield Bonds	Common Stock	Preferred Stock	TOTAL EQUITY	All IPOs	"True" IPOs	Closed-End IPOs	TOTAL UNDER-WRITINGS
1980	36.7	4.4	0.5	41.6	1.4	12.8	3.2	16.0	1.4	1.4	--	57.6
1981	35.1	4.7	0.5	40.3	1.5	13.9	1.7	15.6	3.1	3.1	--	55.9
1982	39.5	3.2	1.1	43.8	2.7	14.0	5.4	19.4	1.3	1.3	--	63.2
1983	37.4	6.1	8.4	51.9	7.8	37.0	8.5	45.5	12.5	12.5	--	97.4
1984	53.2	4.1	12.1	69.4	15.2	9.2	4.0	13.2	3.9	3.8	0.1	82.6
1985	76.4	7.5	20.8	104.7	15.7	24.7	8.6	33.3	8.5	8.4	0.1	138.0
1986	149.8	10.1	67.8	227.7	33.3	43.2	13.9	57.1	22.3	18.1	4.2	284.8
1987	117.8	9.9	91.7	219.4	30.5	41.5	11.4	52.9	24.0	14.3	9.7	272.3
1988	120.3	3.1	113.8	237.2	30.0	29.7	7.6	37.3	23.6	5.7	17.9	274.5
1989	134.1	5.5	135.3	274.9	27.6	22.9	7.7	30.6	13.7	6.1	7.6	305.5
1990	106.9	4.8	178.9	290.6	2.7	19.2	4.7	23.9	10.1	4.5	5.6	314.4
1991												
Jan	10.2	0.4	14.1	24.6	0.4	1.3	0.0	1.3	0.8	0.7	0.1	25.9
Feb	17.7	0.6	18.3	36.6	0.4	2.0	0.3	2.4	0.7	0.1	0.5	39.0
Mar	16.6	1.3	24.0	41.9	0.2	3.5	1.3	4.8	1.2	0.7	0.5	46.7
Apr	20.7	0.7	22.7	44.0	2.4	6.4	0.8	7.1	1.4	0.9	0.5	51.2
May	14.6	0.7	28.7	44.0	0.7	7.9	1.7	9.5	2.0	1.4	0.6	53.5
June	14.0	1.0	27.1	42.1	0.8	4.9	1.9	6.8	2.3	1.5	0.8	49.0
July	8.8	0.5	22.8	32.1	0.6	3.7	0.3	4.0	2.4	2.2	0.2	36.2
Aug	16.6	0.5	29.0	46.1	0.6	2.6	2.1	4.7	1.7	1.3	0.4	50.8
Sept	15.5	0.3	31.9	47.8	0.7	4.4	1.3	5.7	2.5	0.6	1.9	53.4
Oct												
Nov												
Dec												
Y-T-D	134.7	6.0	218.5	359.3	6.7	36.7	9.7	46.4	14.9	9.3	5.6	405.7
Prior YTD	74.7	4.1	138.2	217.0	2.4	16.1	3.7	19.8	8.5	4.3	4.2	236.8
% Change	80.3%	47.6%	58.2%	65.6%	181.4%	127.7%	162.4%	134.2%	75.7%	115.8%	33.9%	71.3%

Note: High-yield bonds is a subset of straight corporate debt.
IPOs is a subset of common stock; "true" and closed-end fund IPOs are subsets of all IPOs.

Source: Securities Data Company

	MUTUAL FUND SALES ($ Billions)						MUTUAL FUND ASSETS ($ Billions)			
	Equity		Bond & Income		TOTAL					
Year	Total Sales	Net Sales	Total Sales	Net Sales	Total Sales	Net Sales	Equity	Bond & Income	Short-Term*	TOTAL ASSETS
1980	5.4	0.2	4.5	1.6	10.0	1.8	24.0	16.8	76.4	117.2
1981	5.8	1.0	4.0	1.2	9.7	2.2	39.0	16.2	186.2	241.4
1982	8.0	3.2	7.7	5.0	15.7	8.2	51.4	25.5	219.8	296.7
1983	22.1	13.2	18.2	12.4	40.3	25.6	75.8	37.8	179.4	293.0
1984	20.3	9.4	25.5	16.5	45.9	25.8	83.1	49.6	233.6	366.3
1985	30.1	11.9	84.2	68.6	114.3	80.6	116.9	134.8	243.8	495.5
1986	57.7	30.5	158.1	118.3	215.8	148.8	161.5	262.6	292.2	716.3
1987	72.1	31.9	118.6	42.5	190.6	74.4	180.7	273.2	316.1	769.9
1988	31.0	-3.8	64.3	6.6	95.3	2.8	194.8	277.5	338.0	810.3
1989	54.5	16.2	71.2	17.9	125.7	34.1	249.0	304.8	428.1	982.0
1990	71.7	25.7	78.6	25.6	150.4	51.3	245.4	324.5	499.0	1,068.9
1991										
Jan	5.3	1.0	8.1	3.5	13.4	4.5	258.4	331.9	535.4	1,125.7
Feb	5.7	2.1	8.2	4.1	13.9	6.2	279.7	336.8	550.0	1,166.5
Mar	6.9	2.4	8.9	4.4	15.8	6.7	287.1	342.4	551.7	1,181.3
Apr	9.2	3.9	11.2	6.3	20.4	10.2	292.4	354.7	549.9	1,196.9
May	7.5	2.9	10.7	6.3	18.3	9.3	309.4	362.5	548.4	1,220.2
June	7.0	2.8	9.9	5.4	17.0	8.2	296.6	365.0	532.8	1,194.5
July	8.3	3.7	11.1	6.7	19.4	10.3	312.6	376.9	536.4	1,226.9
Aug	7.8	3.1	12.2	7.3	20.0	10.5	323.4	390.5	540.9	1,254.8
Sept										
Oct										
Nov										
Dec										
Y-T-D	57.8	21.9	80.4	44.0	138.2	65.9	323.4	390.5	540.9	1,254.8
Prior YTD	51.1	18.8	53.3	18.4	104.4	37.2	243.8	310.9	484.7	1,039.4
% Change	13.2%	16.8%	50.7%	138.9%	32.3%	77.3%	32.6%	25.6%	11.6%	20.7%

* Money market and short-term municipal bond funds

Source: Investment Company Institute

STOCK MARKET PERFORMANCE INDICES

(End of Period)

	Dow Jones Industrial Average	S&P 500	NYSE Composite	Amex Market Value	NASDAQ Composite
1980	963.99	135.76	77.86	174.50	202.34
1981	875.00	122.55	71.11	160.32	195.84
1982	1,046.54	140.64	81.03	170.30	232.41
1983	1,258.64	164.93	95.18	223.01	278.60
1984	1,211.57	167.24	96.38	204.26	247.35
1985	1,546.67	211.28	121.58	246.13	324.93
1986	1,895.95	242.17	138.58	263.27	348.83
1987	1,938.83	247.08	138.23	260.35	330.47
1988	2,168.57	277.72	156.26	306.01	381.38
1989	2,753.20	353.40	195.04	378.00	454.82
1990	2,633.66	330.22	180.49	308.11	373.84
1991					
Jan	2,736.39	343.93	187.59	317.54	414.20
Feb	2,882.18	367.07	200.70	346.13	453.05
Mar	2,913.86	375.22	205.30	359.20	482.30
Apr	2,887.87	375.35	205.37	360.76	484.72
May	3,027.50	389.83	212.99	371.99	506.11
June	2,906.75	371.16	203.47	358.12	475.92
July	3,024.82	387.81	212.34	368.28	502.04
Aug	3,043.60	395.43	216.69	372.13	525.68
Sept	3,016.77	387.86	213.34	374.58	526.88
Oct					
Nov					
Dec					
Y-T-D	3,016.77	387.86	213.34	374.58	526.88
Prior YTD	2,452.48	306.05	167.85	307.72	344.51
% Change	23.0%	26.7%	27.1%	21.7%	52.9%

STOCK MARKET VOLUME

(Daily Average, Millions of Shares)

	NYSE	AMEX	NASDAQ
1980	44.9	6.4	26.4
1981	46.9	5.3	30.9
1982	65.1	5.3	33.3
1983	85.3	8.2	62.9
1984	91.1	6.1	59.9
1985	109.2	8.3	82.1
1986	141.0	11.8	113.6
1987	188.9	13.9	149.8
1988	161.5	9.9	122.8
1989	165.5	12.4	133.1
1990	156.8	13.2	131.9
1991			
Jan	165.3	10.9	133.0
Feb	224.9	16.6	174.9
Mar	195.0	15.3	180.2
Apr	182.3	13.1	187.3
May	170.1	11.0	153.7
June	163.0	11.5	142.5
July	157.2	10.5	140.9
Aug	171.5	12.5	152.6
Sept	162.3	13.4	159.2
Oct			
Nov			
Dec			
Y-T-D	176.2	12.7	157.9
Prior YTD	157.3	13.9	136.5
% Change	12.0%	-8.5%	15.7%

U.S. PRIVATE PLACEMENTS
(In $ Billions)

MUNICIPAL BOND UNDERWRITINGS
(In $ Billions)

	U.S. PRIVATE PLACEMENTS			MUNICIPAL BOND UNDERWRITINGS						
	Debt	Equity	TOTAL PRIVATES	Competitive Revenue Bonds	Negotiated Revenue Bonds	TOTAL REVENUE BONDS	Competitive G.O.s	Negotiated G.O.s	TOTAL G.O.s	TOTAL MUNICIPAL BONDS
1980	13.8	1.9	15.7	5.8	23.8	29.6	10.4	1.3	11.7	41.3
1981	16.3	1.5	17.8	4.1	25.8	29.9	9.5	1.2	10.7	40.6
1982	25.9	1.5	27.4	5.4	48.0	53.4	14.2	2.9	17.1	70.5
1983	32.7	2.9	35.6	6.2	54.5	60.7	11.4	4.8	16.2	76.9
1984	42.3	3.6	45.9	5.9	69.5	75.4	12.6	7.1	19.7	95.1
1985	70.4	9.3	79.7	10.2	150.8	161.0	17.6	22.8	40.4	201.4
1986	107.1	12.4	119.5	10.0	92.6	102.6	23.1	22.6	45.7	148.3
1987	119.9	14.5	134.4	7.1	64.4	71.5	16.3	14.2	30.5	102.0
1988	172.7	17.9	190.6	7.6	78.1	85.7	19.2	12.7	31.9	117.6
1989	168.5	31.5	200.0	9.2	75.8	85.0	20.7	17.2	37.9	122.9
1990	113.6	17.5	131.1	7.6	78.4	86.0	22.7	17.5	40.2	126.2
1991										
Jan	8.9	0.5	9.3	0.9	4.3	5.2	1.6	0.9	2.5	7.7
Feb	6.0	1.1	7.1	0.2	6.1	6.3	3.3	2.3	5.6	11.9
Mar	10.1	0.6	10.7	0.7	6.3	7.0	2.0	2.0	4.0	11.0
Apr	9.0	1.4	10.4	1.1	7.1	8.2	2.2	1.4	3.6	11.8
May	6.7	1.0	7.7	1.2	9.3	10.5	2.8	2.0	4.8	15.3
June	15.4	1.2	16.6	1.1	11.3	12.4	3.0	2.7	5.7	18.2
July				0.8	7.9	8.7	2.7	1.4	4.1	12.8
Aug				1.1	10.4	11.4	3.0	3.2	6.3	17.7
Sept				1.0	7.7	8.8	1.8	2.5	4.4	13.1
Oct										
Nov										
Dec										
Y-T-D	56.1	5.7	61.8	8.1	70.4	78.5	22.6	18.4	41.0	119.4
Prior YTD	57.6	10.1	67.7	5.5	58.2	63.8	17.2	12.3	29.5	93.3
% Change	-2.6%	-43.1%	-8.6%	46.7%	20.8%	23.1%	31.0%	49.6%	38.7%	28.0%

Source: Securities Data Company

RECENT INTERESTING READING AND STATISTICAL MATERIAL

Item	Description	Source
Report on Management and Professional Earnings	SIA study presents detailed compensation data provided by 57 member firms employing 115,000 individuals. This 361-page report covers 138 management and professional positions including attorneys, auditors, traders, and research analysts. Includes tables indicating 1990 bonuses compared with 1989 levels.	SIA Pam Faber, Surveys Manager $450 to $675 based on firm size
Report on Office Salaries	SIA study presents data on 79 non-exempt positions in 57 SIA member firms employing over 86,000 individuals. Job categories include secretarial, sales assistant, administrative, clerical and operations position. This 217-page report presents average, median, and percentile figures as of 5/1/91 for cities covered and compares current data to comparable 1990 figures.	SIA Pam Faber, Surveys Manager $450 to $675 based on firm size
Corporate Financing-- 3rd-Quarter Rankings	Activity in some markets slowed a bit in the third quarter, but 1991's momentum has already pushed the year to a record domestic new issue total, $421 billion compared with 1990's full-year $328 billion. Common stock issuance has climbed to $37.0 billion through the third quarter, more than double the $16.1 billion issued in the same period in 1990. Merrill Lynch held on to its top position in lead-managing of all domestic securities, with a market share of 18.2%. Goldman Sachs places second, with an 11.6% share of this year's new issues. Detailed issuance and ranking data for domestic, international and municipal financings.	Investment Dealers' Digest October 7, 1991
Capital Gains Taxes in the Short Run	CBO study focusing on incentive and revenue effects of various types of capital gains rate reductions in the short run. No discussion of policy implications. Two main conclusions: 1. A prospective cut in capital gains taxes (one limited to capital gains on newly purchased	Congressional Budget Office Washington

Item	Description	Source
	assets) would create stronger incentives for investors to realize gains on existing assets than would a retrospective tax reduction applying to all capital gains. 2. A prospective cut could mean a smaller revenue loss. Study will, no doubt, provide fuel for diffusing any momentum for a retrospective capital gains cut.	
Global Financial Markets International Coordination of Automation Risks	GAO examines how international securities and futures markets use or plan to use automation for 3 market functions: order routing and execution, information dissemination, and clearance and settlement in 13 countries. Study finds most markets have automated or plan to automate these functions, but steps to strengthen control over automation risks vary widely in comprehensiveness. Moreover, although several international organizations have addressed aspects of automation, such efforts have lacked the marketwide coordination needed to systematically reduce the risks introduced by automation.	U.S. General Accounting Office P.O. Box 6015 Gaithersburg, MD 20877
"The Bank Credit "Crumble""	Article explores the role played by cutbacks in commercial loan supply in the 1990 economic downturn. A credit "crumble" as opposed to "crunch" results when a decline in the value of classes of bank loans or investments leads to a reduction in either the willingness or capacity of banks to expand their lending. In 1990, both a credit crumble and a shortage of bank capital were affecting a contraction in the supply of commercial loans.	Quarterly Review Federal Reserve Bank of New York Summer 1991
"Services Under Siege -- The Restructuring Imperative"	Foreign competition and deregulation are exposing the U.S. service sector's hidden vulnerabilities: overinvestment in information technology and chronic inefficiency. In other words, Author Stephen Roach notes that the services sector in the 1990s is undergoing the same difficult shrinkage that manufacturing suffered in the 1980s. While it is not too late for the service sector to respond, the author cautions against overzealous cost cutting that comes at the expense of securing long-lasting competitive strength. Indeed, the challenge facing services is primarily managerial -- running the gamut from an appropriate accounting system to exploiting economies of scale.	Harvard Business Review September - October 1991